IMAGE SENSING SYSTEMS INC
Form 10-Q
August 10, 2017
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

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: 0-26056

Image Sensing Systems, Inc.

(Exact Name of Registrant as Specified in its Charter)

Minnesota	41-1519168
State or Other Jurisdiction of Incorporation or Organization	I.R.S. Employer Identification No.
500 Spruce Tree Centre 1600 University Avenue West St. Paul, MN	55104
Address of Principal Executive Offices	Zip Code

(651) 603-7700

Registrant’s Telephone Number, Including Area Code

Not Applicable

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x
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 Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2017
Common Stock, $0.01 par value per share	5,168,381 shares

IMAGE SENSING SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Image Sensing Systems, Inc.

Condensed Consolidated Balance Sheets
(in thousands)

	June 30, 2017 (Unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,656	$ 1,547
Accounts receivable, net of allowance for doubtful accounts of $139 and $90, respectively	2,302	3,011
Inventories	273	141
Prepaid expenses and other current assets	347	281
Total current assets	5,578	4,980
Property and equipment:		
Furniture and fixtures	491	486
Leasehold improvements	426	426
Equipment	3,702	3,561
	4,619	4,473
Accumulated depreciation	4,253	4,102
	366	371
Intangible assets, net	3,181	2,795
Deferred income taxes	60	58
TOTAL ASSETS	$ 9,185	$ 8,204
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 634	$ 256
Warranty	1,072	1,223
Accrued compensation	183	193
Other current liabilities	382	323
Total current liabilities	2,271	1,995
TOTAL LIABILITIES	2,271	1,995
Shareholders' equity:		
Preferred stock, $0.01 par value; 5,000,000 shares authorized, none issued or outstanding	—	—
Common stock, $0.01 par value; 20,000,000 shares authorized, 5,168,381 and 5,094,473 issued and outstanding at June 30, 2017 and December 31, 2016, respectively	51	50
Additional paid-in capital	24,207	24,055
Accumulated other comprehensive loss	(332)	(363)

Accumulated deficit	(17,012)	(17,533)
Total shareholders' equity	6,914	6,209
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 9,185	$ 8,204

See accompanying notes to the condensed consolidated financial statements.

Image Sensing Systems, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

(in thousands, except per share data)

	Three-Month Periods Ended June 30,		Six-Month Periods Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Product sales	$ 1,629	$ 2,321	$ 3,069	$ 3,935
Royalties	1,846	2,356	3,490	3,980
	3,475	4,677	6,559	7,915
Cost of revenue:				
Product sales	708	964	1,252	1,882
Software amortization	90	—	180	—
	798	964	1,432	1,882
Gross profit	2,677	3,713	5,127	6,033
Operating expenses:				
Selling, general and administrative	1,656	1,916	3,092	3,605
Research and development	728	603	1,544	1,397
Restructuring	—	—	—	126
	2,384	2,519	4,636	5,128
Operating income from operations	293	1,194	491	905
Other, net	30	1	33	—
Income from operations before income taxes	323	1,195	524	905
Income tax expense	—	2	4	4
Net income	$ 323	$ 1,193	$ 520	$ 901
Net income per share:				
Basic	$ 0.06	$ 0.24	$ 0.10	$ 0.18
Diluted	$ 0.06	$ 0.24	$ 0.10	$ 0.18
Weighted average number of common shares outstanding:				
Basic	5,117	5,041	5,107	5,035
Diluted	5,128	5,041	5,107	5,035

See accompanying notes to the condensed consolidated financial statements.

Image Sensing Systems, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands)

	Three-Month Periods Ended June 30,		Six-Month Periods Ended June 30,	
	2017	2016	2017	2016
Net income	$ 323	$ 1,193	$ 520	$ 901
Other comprehensive income:				
Foreign currency translation adjustment	24	(48)	31	(47)
Comprehensive income	$ 347	$ 1,145	$ 551	$ 854

See accompanying notes to the condensed consolidated financial statements.

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Image Sensing Systems, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	Six-Month Periods Ended June 30,	
	2017	2016
Operating activities:		
Net income	$ 520	$ 901
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation	127	149
Software amortization	180	—
Stock-based compensation	153	60
Loss on disposal of assets	—	1
Changes in operating assets and liabilities:		
Accounts receivable, net	709	(1,176)
Inventories	(132)	419
Prepaid expenses and other current assets	(69)	8
Accounts payable	237	(129)
Accrued expenses and other current liabilities	(102)	(660)
Net cash provided by (used for) operating activities	1,623	(427)
Investing activities:		
Capitalized software development costs	(441)	(1,124)
Purchases of property and equipment	(101)	(73)
Net cash used for investing activities	(542)	(1,197)
Effect of exchange rate changes on cash	28	(60)
Increase (decrease) in cash and cash equivalents	1,109	(1,684)
Cash and cash equivalents at beginning of period	1,547	2,648
Cash and cash equivalents at end of period	$ 2,656	$ 964
Non-Cash investing and financing activities:		
Purchase of property and equipment in accounts payable	$ 16	$ —
Capitalization of software development costs in accounts payable	125	—

See accompanying notes to the condensed consolidated financial statements.

IMAGE SENSING SYSTEMS, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2017

Note A: Basis of Presentation

Image Sensing Systems, Inc. (referred to in this Quarterly Report on Form 10-Q as "we," "us," "our" and the "Company") develops and markets video and radar processing products for use in applications such as intersection control, highway, bridge and tunnel traffic management and traffic data collection. We sell our products primarily to distributors and also receive royalties under a license agreement with a manufacturer/distributor for certain of our products. Our products are used primarily by governmental entities.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to the Quarterly Report on Form 10-Q, which require the Company to make estimates and assumptions that affect amounts reported. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. It is the opinion of management that the unaudited condensed consolidated financial statements include all adjustments consisting of normal recurring accruals considered necessary for a fair presentation. All significant intercompany balances and transactions have been eliminated.

Operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The accompanying condensed consolidated financial statements of the Company should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 as filed with the SEC.

Summary of Significant Accounting Policies

The Company believes that of its significant accounting policies, the following are particularly important to the portrayal of the Company's results of operations and financial position and may require the application of a higher level of judgment by the Company's management and, as a result, are subject to an inherent degree of uncertainty.

Revenue Recognition

We recognize revenue on a sales arrangement when it is realized or realizable and earned, which occurs when all of the following criteria have been met: persuasive evidence of an arrangement exists; delivery and title transfer have occurred or services have been rendered; the sales price is fixed and determinable; collectability is reasonably assured; and all significant obligations to the customer have been fulfilled.

Certain sales may contain multiple elements for revenue recognition purposes. We consider each deliverable that provides value to the customer on a standalone basis as a separable element. Separable elements in these arrangements may include the hardware, software, installation services, training and support. We initially allocate consideration to each separable element using the relative selling price method. Selling prices are determined by us based on either vendor-specific objective evidence ("VSOE") (the actual selling prices of similar products and services sold on a standalone basis) or, in the absence of VSOE, our best estimate of the selling price. Factors considered by us in determining estimated selling prices for applicable elements generally include overall economic conditions, customer demand, costs incurred by us to provide the deliverable, as well as our historical pricing practices. Under these arrangements, revenue associated with each delivered element is recognized in an amount equal to the lesser of the consideration initially allocated to the delivered element or the amount for which payment is not deemed contingent upon future delivery of other elements in the arrangement. Under arrangements where special acceptance protocols exist, installation services and training may not be considered separable. Under those circumstances, revenue for the entire arrangement is recognized upon the completion of installation, training and fulfillment of any other significant obligations specific to the terms of the arrangement. Arrangements that do not contain any separable elements are typically recognized when the products are shipped and title has transferred to the customer.

Revenue from arrangements for services such as maintenance, repair, consulting and technical support are recognized either as the service is performed or ratably over the defined contractual period for service maintenance contracts.

Econolite Control Products, Inc. (Econolite) is our licensee that sells certain of our products in the United States, Mexico, Canada and the Caribbean. The royalty of approximately 50% of the gross profit on licensed products is recognized when the products are shipped or delivered by Econolite to its customers.

We record provisions against sales revenue for estimated returns and allowances in the period when the related revenue is recorded based on historical sales returns and changes in end user demand.

Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Inventories

Inventories are primarily electronic components and finished goods and are valued at the lower of cost or market on the first-in, first-out accounting method.

Income Taxes

We record a tax provision for the anticipated tax consequences of the reported results of operations. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those deferred tax assets and liabilities are expected to be realized or settled. We record a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. We believe it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining net realizable value of deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management’s expectations could have a material impact on our financial condition and operating results. We recognize penalties and interest expense related to unrecognized tax benefits in income tax expense.

Intangible Assets

We capitalize certain software development costs related to software to be sold, leased, or otherwise marketed. Capitalized software development costs include purchased materials, services, internal labor and other costs associated with the development of new products and services. Software development costs are expensed as incurred until technological feasibility has been established, at which time future costs incurred are capitalized until the product is available for general release to the public. Based on our product development process, technological feasibility is generally established once product and detailed program designs have been completed, uncertainties related to high-risk development issues have been resolved through coding and testing, and we have established that the necessary skills, hardware, and software technology are available for production of the product. Once a software product is available for general release to the public, capitalized development costs associated with that product will begin to be amortized to cost of sales over the product's estimated economic life, using the greater of straight-line or a method that results in cost recognition in future periods that is consistent with the anticipated timing of product revenue recognition.

Capitalized software development costs are subject to an ongoing assessment of recoverability, which is impacted by estimates and assumptions of future revenues and expenses for these software products, as well as other factors such as changes in product technologies. Any portion of unamortized capitalized software development costs that is determined to be in excess of net realizable value has been expensed in the period in which such a determination is made. We reached technological feasibility for certain software products and, as a result, capitalized approximately $392,000 and $523,000 of software development costs during the quarters ended June 30, 2017 and 2016, respectively.

Intangible assets with finite lives are amortized on a straight-line basis over the expected period to be benefited by future cash flows and reviewed for impairment. At both June 30, 2017 and December 31, 2016, we determined there was no impairment of intangible assets. At both June 30, 2017 and 2016, there were no indefinite-lived intangible assets.

Note B: Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, “Compensation-Stock Compensation (Topic 718)." ASU 2016-09 provides guidance on how an entity should account for stock compensation. It is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. The Company adopted ASU 2016-09 effective January 1, 2017, and the adoption did not have a material impact to the consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." ASU 2016-02 provides guidance on how an entity should account for leases and recognize associated lease assets and liabilities. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. ASU 2016-02 must be adopted using a modified retrospective transition, and it provides for certain practical expedients. In addition, the transition will require application of ASU 2016-02 at the beginning of the earliest comparative period presented. We are currently determining our implementation approach and assessing the impact of ASU 2016-02 on the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 provides guidance related to how an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, ASU 2014-09 specifies accounting for costs associated with obtaining or fulfilling contracts with customers and expands the required disclosures related to revenue and cash flows from contracts with customers.

On July 9, 2015, the FASB affirmed its proposal to defer the effective date of ASU 2014-09 for all entities by one year. As a result, public business entities, certain not-for-profit entities, and certain employee benefit plans will apply this revenue standard to annual reporting periods beginning after December 15, 2017. All other entities will apply ASU 2014-09 to annual reporting periods beginning after December 15, 2018. Additionally, the FASB affirmed its proposal to permit all entities to apply ASU 2014-09 early, but not before the original effective date for public business entities, certain not-for-profit entities, and certain employee benefit plans (that is, annual periods beginning after December 15, 2016). Entities choosing to implement early will apply ASU 2014-09 to all interim reporting periods within the year of adoption. The Company is currently determining its implementation approach and assessing the impact of ASU 2014-09 on the consolidated financial statements.

Note C: Fair Value Measurements

The guidance for fair value measurements establishes the authoritative definition of fair value, sets out a framework for measuring fair value and outlines the required disclosures regarding fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. We use a three-tier fair value hierarchy based upon observable and non-observable inputs as follows:

Level 1 - observable inputs such as quoted prices in active markets;

Level 2 - inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 - unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis

Our intangible assets and other long-lived assets are nonfinancial assets that were acquired either as part of a business combination, individually or with a group of other assets. These nonfinancial assets were initially, and have historically been, measured and recognized at amounts equal to the fair value determined as of the date of acquisition.

Financial Instruments not Measured at Fair Value

Certain of our financial instruments are not measured at fair value and are recorded at carrying amounts approximating fair value, based on their short-term nature or variable interest rate. These financial instruments include cash and cash equivalents, accounts receivable, accounts payable and other current financial assets and liabilities.

Note D: Inventories

Inventories consisted of approximately $273,000 and $141,000 of finished goods as of June 30, 2017 and December 31, 2016, respectively.

Note E: Intangible Assets

Intangible assets consisted of the following (dollars in thousands):

	June 30, 2017			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life (in Years)
Developed technology	$ 3,900	(3,900)	$ —	—
Vision development costs	2,885	(270)	2,615	8.0
Software development costs	566	—	566	—
Total	$ 7,351	$ (4,170)	$ 3,181	8.0

	December 31, 2016			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life (in Years)
Developed technology	$ 3,900	$ (3,900)	$ —	—
Vision development costs	2,885	(90)	2,795	8.0
	$ 6,785	$ (3,990)	$ 2,795	8.0

Note F: Credit Facilities

In May 2014, the Company entered into a credit agreement and related documents with Alliance Bank which provided for a revolving line of credit for the Company. The credit agreement and related documents with Alliance Bank (collectively, the "Alliance Credit Agreement") provided up to a $5.0 million revolving line of credit bearing interest at a fixed annual rate of 3.95%. Any advances would have been secured by the Company's inventories, accounts receivable, cash, marketable securities, and equipment. We were subject to certain covenants under the Alliance Credit Agreement. In April 2016, we entered into an agreement with Alliance Bank amending the Alliance Credit Agreement to extend the maturity date from April 1, 2016 to May 12, 2017. We chose not to renew the Alliance Credit Agreement.

Note G: Warranties

We generally provide a two to five year warranty on product sales. Reserves to honor warranty claims are estimated and recorded at the time of sale based on historical claim information and are analyzed and adjusted periodically based on claim trends.

Warranty liability and related activity consisted of the following (in thousands):

	Six-Month Periods Ended June 30, 2017	2016
Beginning balance	$ 1,223	$ 760
Warranty provisions	26	81
Warranty claims	(74)	(147)
Adjustments to preexisting warranties	(107)	(84)
Currency	4	—
Ending balance	$ 1,072	$ 610

Note H: Stock-Based Compensation

We compensate officers, directors, key employees and consultants with stock-based compensation under stock option and incentive plans (the "Plans") approved by our shareholders and administered under the supervision of our Board of Directors. Stock option awards are granted at exercise prices equal to the closing price of our stock on the day before the date of grant. Generally, options vest proportionally over periods of three to five years from the dates of the grant, beginning one year from the date of grant, and have a contractual term of nine to ten years.

Performance stock options are time based; however, the final number of awards earned and the related compensation expense is adjusted up or down to the extent the performance target is met. The actual number of shares that will ultimately vest ranges from 90% to 100% of the targeted amount if the minimum performance target is achieved. We evaluate the likelihood of meeting the performance target at each reporting period and adjust compensation expense, on a cumulative basis, based on the expected achievement of each performance target.

Compensation expense, net of estimated forfeitures, is recognized ratably over the vesting period. Stock-based compensation expense included in general and administrative expense for the three-month periods ended June 30, 2017 and 2016 was $88,000 and $1,000, respectively. Stock-based compensation expense included in general and administrative expense for the six-month periods ended June 30, 2017 and 2016 was $153,000 and $60,000, respectively. At June 30, 2017, 232,980 shares were available for grant under the Company's stock option and incentive plan.

Stock Options

A summary of the option activity for the first six months of 2017 is as follows:

	Number of Shares	**Weighted Average Exercise Price per Share**	**Weighted Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value**
Options outstanding at December 31, 2016	132,500	$ 6.15	4.50	$ —
Granted	—	$ —	—	$ —
Exercised	—	$ —	—	$ —
Expired	(8,000)	$ 10.15	—	$ —
Forfeited	(22,000)	$ 5.72	—	$ —
Options outstanding at June 30, 2017	102,500	$ 5.93	4.04	$ —
Options exercisable at June 30, 2017	91,875	$ 6.05	3.73	$ —

There were no options exercised during the three and six month periods ended June 30, 2017 and June 30, 2016. As of June 30, 2017, there was $14,000 of total unrecognized compensation cost related to non-vested stock options. The weighted average period over which the compensation cost is expected to be recognized is 0.79 of a year.

Restricted Stock Awards and Stock Awards

Restricted stock awards are granted under the Plan at the discretion of the Compensation Committee of our Board of Directors. We issue restricted stock awards to executive officers and key consultants. These awards may contain certain performance conditions or time-based vesting criteria. Executive officers vest in the restricted stock awards if the various performance or time-based metrics are met. Stock-based compensation is recognized for the number of awards expected to vest at the end of the period and is expensed beginning on the grant date through the end of the vesting period. At time of vesting, the recipients of common stock may request to receive a net of the number of shares required for employee withholding taxes, which can be withheld up to the relevant jurisdiction's maximum statutory rate. Stock awards to consultants are recognized over the performance period based on the stock price on the date when the consultant's performance is complete.

We also issue stock awards as a portion of the annual retainer for each director on a quarterly basis. The stock awards are fully vested at the time of issuance. Compensation expense related to stock awards is determined on the grant date based on the publicly quoted fair market value of our common stock and is charged to earnings on the grant date.

A summary of the restricted stock awards and stock award activity for the first six months of 2017 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Awards outstanding December 31, 2016	—	$ —
Granted	73,908	3.09
Vested	(41,908)	3.20
Expired	—	—
Forfeited	—	—
Awards outstanding at June 30, 2017	32,000	$ 2.70

As of June 30, 2017, the total stock-based compensation expense related to non-vested awards not yet recognized was $68,000, which is expected to be recognized over a weighted average period of 2.70 years. The weighted average grant date fair value of restricted stock units granted during the six-month period ended June 30, 2017 was $3.09. We granted restricted stock awards of 73,908 shares during the six-month period ended June 30, 2017. During the six-month periods ended June 30, 2017 and June 30, 2016, we recognized $142,000 and $55,000, respectively, of stock-based compensation expense related to restricted stock awards.

Note I: Income per Common Share

Net income per share is computed by dividing net income by the daily weighted average number of common shares outstanding during the applicable periods. Diluted net income per share includes the potentially dilutive effect of common shares subject to outstanding stock options using the treasury stock method. Under the treasury stock method, shares subject to certain outstanding stock options have been excluded from the diluted weighted average shares outstanding calculation because the exercise of those options would lead to a net reduction in common shares outstanding. As a result, stock options to acquire 107,247 and 296,640 weighted common shares have been excluded from the diluted weighted shares outstanding for the three-month periods ended June 30, 2017 and 2016, respectively, and 132,273 and 300,271 weighted common shares have been excluded from the diluted weighted shares outstanding for the six-month periods ended June 30, 2017 and 2016, respectively.

A reconciliation of net income per share is as follows (dollar amounts in thousands except per share data):

	Three-Month Periods Ended June 30,		Six-Month Periods Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income	$323	$ 1,193	$520	$901
Denominator:				
Weighted average common shares outstanding	5,117	5,041	5,107	5,035
Dilutive potential common shares	11	—	—	—
Shares used in diluted net loss per common share calculations	5,128	5,041	5,107	5,035
Basic net income per common share	$ 0.06	$ 0.24	$ 0.10	$ 0.18
Diluted net income per common share	$ 0.06	$ 0.24	$ 0.10	$ 0.18

Note J: Segment Information

The Company's Chief Executive Officer and management regularly review financial information for the Company's discrete operating segments. Based on similarities in the economic characteristics, nature of products and services, production processes, type or class of customer served, method of distribution and regulatory environments, the operating segments have been aggregated for financial statement purposes and categorized into two reportable segments: Intersection and Highway.

Autoscope video is our machine-vision product line, and revenue consists of royalties (all of which are received from Econolite), as well as a portion of international product sales. Video products are normally sold in the Intersection segment. RTMS is our radar product line, and revenue consists of international and North American product sales. Radar products are normally sold in the Highway segment. All segment revenues are derived from external customers.

Operating expenses and total assets are not allocated to the segments for internal reporting purposes. Due to the changes in how we manage our business, we may reevaluate our segment definitions in the future.

The following tables set forth selected unaudited financial information for each of our reportable segments (in thousands):

Three Months Ended June 30,

	Intersection		Highway		Total	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Revenue	$ 2,214	$ 2,697	$ 1,261	$ 1,980	$ 3,475	$ 4,677
Gross profit	1,954	2,534	723	1,179	2,677	3,713
Amortization of intangible assets	90	—	—	—	90	—
Intangible assets	2,635	2,335	546	—	3,181	2,335

	Six Months Ended June 30,					
	Intersection		**Highway**		**Total**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Revenue	$ 4,118	$ 4,601	$ 2,441	$ 3,314	$ 6,559	$ 7,915
Gross profit	3,689	4,252	1,438	1,781	5,127	6,033
Amortization of intangible assets	180	—	—	—	180	—
Intangible assets	2,635	2,335	546	—	3,181	2,335

Note K: Restructuring and Exit Activities

In the first quarter of 2016, the Company implemented restructuring plans in Canada. Because of these actions, restructuring charges of approximately $126,000 were recorded in the first six months of 2016 related to employee terminations.

The following table shows the restructuring activity for the six months ended June 30, 2016 (in thousands):

	Termination Benefits	Facility Costs and Contract Termination	Total
Balance at January 1, 2016	$ —	$ —	$ —
Charges	126	—	126
Payments/settlements	—	—	—
Balance at March 31, 2016	$ 126	$ —	$ 126
Payments/settlements	(93)	—	(93)
Balance at June 30, 2016	$ 33	$ —	$ 33

No restructuring charges were recorded in the three and six months ended June 30, 2017.

Note L: Commitments and Contingencies

Litigation

We are involved from time to time in various legal proceedings arising in the ordinary course of our business, including primarily commercial, product liability, employment and intellectual property claims. In accordance with generally accepted accounting principles in the United States, we record a liability in our Consolidated Financial Statements with respect to any of these matters when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible additional losses either because we believe that we have valid defenses to claims asserted against us or the proceeding has not advanced to a stage of discovery that would enable us to establish an estimate. We currently do not expect the outcome of these matters to have a material effect on our consolidated results of operations, financial position or cash flows. Litigation, however, is inherently unpredictable, and it is possible that the ultimate outcome of one or more claims asserted against us could adversely impact our results of operations, financial position or cash flows. We expense legal costs as incurred.

On May 5, 2016, Econolite, our exclusive North American manufacturer and distributor, served a complaint on us for a lawsuit filed by Econolite in the Superior Court of the State of California for the County of Orange. The complaint asserted claims against us under the Manufacturing, Distributing and Technology License Agreement, as amended, with Econolite (the "Econolite Agreement") for breach of contract and breach of implied covenant of good faith and fair dealing and sought specific performance related to the transition of North American RTMS sales and marketing activities from Econolite to us in July 2014. In the complaint, Econolite requested damages from us in an amount to be proven at trial and sought certain other remedies. On May 27, 2016, we removed the case to the Federal District Court, District of Central California. On November 15, 2016, Econolite and the Company entered into an Arbitration Agreement. On November 16, 2016, Econolite voluntarily dismissed all of its claims against the Company in the U.S. District Court but filed a demand for arbitration with JAMS (which is an alternative dispute resolution provider), asserting the same claims against the Company that it had asserted in the lawsuit. Arbitration commenced on November 16, 2016, and it remains ongoing. We believe that Econolite's claims are without merit, and we plan to vigorously defend against them. However, we cannot predict the outcome of this matter at this time or whether it will have a material adverse impact on our business prospects, financial condition, operating results or cash flow.

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

Overview

General. We are a leading provider of above-ground detection products and solutions for the intelligent transportation systems ("ITS") industry. Our family of products, which we market as Autoscope® video or video products (“Autoscope”), and RTMS® radar or radar products ("RTMS"), provides end users with the tools needed to optimize traffic flow and enhance driver safety. Our technology analyzes signals from sophisticated sensors and transmits the information to management systems and controllers or directly to users. Our products provide end users with complete solutions for the intersection and transportation markets.

Our technology is a process in which software, rather than humans, examines outputs from various types of sophisticated sensors to determine what is happening in a field of view. In the ITS industry, this process is a critical component of managing congestion and traffic flow. In many cities, it is not possible to build roads, bridges and highways quickly enough to accommodate the increasing congestion levels. On average, United States commuters spend 42 hours a year stuck in traffic, and congestion costs motorists $160 billion a year. We believe this growing use of vehicles will make our ITS solutions increasingly necessary to complement existing and new roadway infrastructure to manage traffic flow and optimize throughput.

We believe our solutions are technically superior to those of our competitors because they have a higher level of accuracy, limit the occurrence of false detection, are generally easier to install with lower costs of ownership, work effectively in a multitude of light and weather conditions, and provide end users the ability to manage inputs from a variety of sensors for a number of tasks. It is our view that the technical advantages of our products make our solutions well suited for use in ITS markets.

We believe the strength of our distribution channels positions us to increase the penetration of our technology driven solutions in the marketplace. We market our Autoscope video products in the United States, Mexico, Canada and the Caribbean through exclusive agreements with Econolite Control Products, Inc. ("Econolite"), which we believe is the leading distributor of ITS intersection control products in these markets.

We market the RTMS radar systems to a network of distributors in North America, the Caribbean and Latin America. On a limited basis, we sell directly to the end user in these geographic areas. We market our Autoscope video and RTMS radar products outside of the United States, Mexico, Canada and the Caribbean through a combination of distribution and direct sales channels, through our offices in Spain and Romania. Our end users primarily include governmental agencies and municipalities.

The following discussion of period-to-period changes and trends in financial statement results under "Management's Discussion and Analysis of Financial Condition and Results of Operations" aligns with the financial statement presentation discussed above.

Trends and Challenges in Our Business

We believe the expected growth in our business can be attributed primarily to the following global trends:

- worsening traffic caused by increased numbers of vehicles in metropolitan areas without corresponding expansions of road infrastructure and the need to automate safety, security and access applications for automobiles and trucks, which has increased demand for our products;
- advances in information technology, which have made our products easier to market and implement;

- the continued funding allocations for centralized traffic management services and automated enforcement schemes, which have increased the ability of our primary end users to implement our products; and
- general increases in the cost effectiveness of electronics, which make our products more affordable for end users.

We believe our continued growth primarily depends upon:

- continued adoption and governmental funding of ITS and other automated applications for traffic control, safety and enforcement in developed countries;
- a propensity by traffic engineers to implement lower cost technology-based solutions rather than civil engineering solutions such as widening roadways;
- countries in the developing world adopting above-ground detection technology, such as video or radar, instead of in-pavement loop technology to manage traffic; and

- our ability to develop new products that provide increasingly accurate information and enhance the end users' ability to cost-effectively manage traffic and environmental issues.

Because the majority of our end users are governmental entities, we are faced with challenges related to potential delays in purchase decisions by those entities and changes in budgetary constraints. These contingencies could result in significant fluctuations in our revenue between periods. The ongoing economic environment in Europe and the United States is further adding to the unpredictability of purchase decisions, creating more delays than usual and decreasing governmental budgets, and it is likely to continue to affect our revenue.

Key Financial Terms and Metrics

Revenue. We derive revenue from two sources: (1) royalties received from Econolite for sales of the Autoscope video systems in the United States, Mexico, Canada and the Caribbean and (2) revenue received from the direct sales of our RTMS radar systems and Autoscope video systems in Europe and Asia. Autoscope video royalties are calculated using a profit sharing model where the gross profits on sales of product made through Econolite are shared equally with Econolite. This royalty arrangement has the benefit of decreasing our cost of revenues and our selling, marketing and product support expenses because these costs and expenses are borne primarily by Econolite. Although this royalty model has a positive impact on our gross margin, it also negatively impacts our total revenue, which would be higher if all the sales made by Econolite were made directly by us. The royalty arrangement is exclusive under a long-term agreement.

Cost of Revenue. Software amortization is the sole cost of revenue related to royalties, as virtually all manufacturing, warranty and related costs are incurred by Econolite. Cost of revenue related to product sales consists primarily of the amount charged by our third party contractors to manufacture hardware platforms, which is influenced mainly by the cost of electronic components. The cost of revenue also includes logistics costs, estimated expenses for product warranties, restructuring costs and inventory reserves. The key metric that we follow is achieving certain gross margin percentages on product sales by geographic region and to a lesser extent by product line.

Operating Expenses. Our operating expenses fall into three categories: (1) selling, marketing and product support; (2) general and administrative; and (3) research and development. Selling, marketing and product support expenses consist of various costs related to sales and support of our products, including salaries, benefits and commissions paid to our personnel; commissions paid to third parties; travel, trade show and advertising costs; second-tier technical support for Econolite; and general product support, where applicable. General and administrative expenses consist of certain corporate and administrative functions that support the development and sales of our products and provide an infrastructure to support future growth. These expenses include management, supervisory and staff salaries and benefits; legal and auditing fees; travel; rent; and costs associated with being a public company, such as board of director fees, listing fees and annual reporting expenses. Research and development expenses consist mainly of salaries and benefits for our engineers and third party costs for consulting and prototyping. We measure all operating expenses against our annually approved budget, which is developed with achieving a certain operating margin as a key focus. Also included in operating expenses are restructuring costs and non-cash expense for intangible asset amortization.

Non-GAAP Operating Measure. We provide certain non-GAAP financial information as supplemental information to financial measures calculated and presented in accordance with GAAP (Generally Accepted Accounting Principles in the United States). This non-GAAP information excludes the impact of amortizing intangible assets and depreciation, and may exclude other non-recurring items. Management believes that this presentation facilitates the comparison of our current operating results to historical operating results. Management uses this non-GAAP information to evaluate short-term and long-term operating trends in our core operations. Non-GAAP information is not prepared in accordance with GAAP and should not be considered a substitute for or an alternative to GAAP financial measures and may not be computed the same as similarly titled measures used by other companies.

Reconciliations of GAAP income from operations to non-GAAP income from operations are as follows (in thousands):

	Three-Month Periods Ended June 30,		Six-Month Periods Ended June 30,	
	2017	**2016**	**2017**	**2016**
Income from operations	$ 293	$ 1,194	$ 491	$ 905
Adjustments to reconcile to non-GAAP income				
Depreciation	62	74	127	149
Amortization of intangible assets	90	—	180	—
Restructuring charges	—	—	—	126
Non-GAAP income from continuing operations	$ 445	$ 1,268	$ 798	$ 1,180

Seasonality. Our quarterly revenues and operating results have varied significantly in the past due to the seasonality of our business. Our first quarter generally is the weakest due to weather conditions that make roadway construction more difficult in parts of North America, Europe and northern Asia. We expect such seasonality to continue for the foreseeable future. Additionally, our international revenues regularly contain individually significant sales. This can result in significant variations of revenue between periods. Accordingly, we believe that quarter-to-quarter comparisons of our financial results should not be relied upon as an indication of our future performance. No assurance can be given that we will be able to achieve or maintain profitability on a quarterly or annual basis in the future.

Segments. We operate in two reportable segments: Intersection and Highway. Autoscope video is our machine-vision product line, and revenue consists of royalties (all of which are received from Econolite), as well as a portion of international product sales. Video products are normally sold in the Intersection segment. The RTMS is our radar product line, and revenue consists of sales to external customers. Radar products are normally sold in the Highway segment. As a result of business model changes and modifications in how we manage our business, we may reevaluate our segment definitions in the future.

The following tables set forth selected unaudited financial information for each of our reportable segments (in thousands):

	Three Months Ended June 30,					
	Intersection		Highway		Total	
	2017	2016	2017	2016	2017	2016
Revenue	$ 2,214	$ 2,697	$ 1,261	$ 1,980	$ 3,475	$ 4,677
Gross profit	1,954	2,534	723	1,179	2,677	3,713
Amortization of intangible assets	90	—	—	—	90	—
Intangible assets	2,635	2,335	546	—	3,181	2,335

	Six Months Ended June 30,					
	Intersection		Highway		Total	
	2017	2016	2017	2016	2017	2016
Revenue	$ 4,118	$ 4,601	$ 2,441	$ 3,314	$ 6,559	$ 7,915
Gross profit	3,689	4,252	1,438	1,781	5,127	6,033
Amortization of intangible assets	180	—	—	—	180	—
Intangible assets	2,635	2,335	546	—	3,181	2,335

Results of Operations

The following table sets forth, for the periods indicated, certain statements of operations data as a percent of total revenue and gross profit on product sales and royalties as a percentage of product sales and royalties, respectively.

	Three-Month Periods Ended			
	June 30,			
	2017		2016	
Product sales	46.9	%	49.6	%
Royalties	53.1		50.4	

Total revenue	100.0	100.0
Gross profit - product sales	56.5	58.5
Gross profit - royalties	95.1	100.0
Selling, general and administrative	47.7	41.0
Research and development	20.9	12.9
Income from operations	9.3	25.6
Income tax expense	—	—
Net income	9.3	25.5

	Six-Month Periods Ended June 30,		
	2017		2016
Product sales	46.8	%	49.7%
Royalties	53.2		50.3
Total revenue	100.0		100.0
Gross profit - product sales	59.2		52.2
Gross profit - royalties	94.8		100.0
Selling, general and administrative	47.1		45.5
Research and development	23.5		17.7
Restructuring	—		1.6
Income from operations	8.0		11.4
Income tax expense	0.1		0.1
Net income	7.9		11.4

Total revenue decreased to \$3.5 million in the three-month period ended June 30, 2017 from \$4.7 million in the same period in 2016, a decrease of 25.7%, and decreased to \$6.6 million in the first six months of 2017 from \$7.9 million in the first six months of 2016, a decrease of 17.1%. Royalty income decreased to \$1.8 million in the second quarter of 2017 from \$2.4 million in the second quarter of 2016, a decrease of 21.6%, and decreased to \$3.5 million in the first six months of 2017 from \$4.0 million in the first six months of 2016, a decrease of 12.3%.

Product sales decreased to \$1.6 million in the second quarter of 2017 from \$2.3 million in the second quarter of 2016, a decrease of 29.8%, and decreased to \$3.1 million in the first six months of 2017 from \$3.9 million in the same period in 2016, a decrease of 22.0%. The decrease in product sales was primarily driven by a soft demand in the Middle East and Europe due to reduced European Union funding.

Revenue for the Intersection segment decreased to \$2.2 million in the three-month period ended June 30, 2017 from \$2.7 million in the three-month period ended June 30, 2016, a decrease of 17.9%. Revenue for the Intersection segment decreased to \$4.1 million in the first six months of 2017 from \$4.6 million in the first six months of 2016, a decrease of 10.5%.

Revenue for the Highway segment decreased to \$1.3 million in the three-month period ended June 30, 2017 from \$2.0 million in the three-month period ended June 30, 2016, a decrease of 36.3%. Revenue for the Highway segment decreased to \$2.4 million in the first six months of 2017 from \$3.3 million in the first six months of 2016, a decrease of 26.3%. The decrease in revenue in the highway segment in the first half of 2017 compared to the prior year period is due to an individually significant radar project into the Middle East that was recognized in the prior year period.

Gross profit for product sales decreased to 56.5% in the three months ended June 30, 2017 from 58.5% in the three months ended June 30, 2016. Product sales gross profit decreased \$436,000 or 32.1% in the three months ended June 30, 2017 compared to the prior year period. Gross profit for product sales increased to 59.2% in the first six months of 2017 from 52.2% in the first six months of 2016. Product sales gross profit decreased \$236,000 or 11.5% in the six months ended June 30, 2017 compared to the prior year period. The increase in gross margin in the six months ended June 30, 2017 is primarily due to a reduction in warranty reserve related to expired warranty coverage for legacy product and improved RTMS margins in the United States. Additionally, the geographic sales mix of our product sales can influence margins, as product sold in some jurisdictions have higher margins. We anticipate that gross profit for our product sales will be similar in 2017 as compared to 2016.

Gross profit for royalty sales for the three months ended June 30, 2017 decreased to 95.1% from 100.0% in the same period in 2016. Gross profit from royalties decreased $600,000 or 25.5% in the three months ended June 30, 2017 compared to the prior year period. Gross profit from royalty sales decreased to 94.8% in the first six months 2017 from 100.0% in the first six months 2016. Gross profit from royalties decreased $670,000 or 16.8% compared to the prior year period. The decrease in royalty gross margins is due to the amortization of software capitalization costs related to the Autoscope Vision product released for sale in October 2016. We expect that royalty gross profit percentage will decrease in 2017 compared to 2016 due to this amortization.

Selling, general and administrative expense was $1.7 million or 47.7% of total revenue in the second quarter of 2017 compared to $1.9 million or 41.0% of total revenue in the second quarter of 2016, and decreased to $3.1 million or 47.1% of total revenue in the first six months of 2017 from $3.6 million or 45.5% of total revenue in the first six months of 2016. The reduction in expense is the result of cost saving measures enacted in 2016. Overall, we anticipate that in 2017 as compared to 2016, selling, general and administrative expense will decrease in dollar amount.

Research and development expense increased to $728,000 or 20.9% of total revenue in the three-month period ended June 30, 2017 from $603,000 or 12.9% of total revenue in the three-month period ended June 30, 2016, and increased to $1.5 million or 23.5% of total revenue in the first six months of 2017 from $1.4 million or 17.7% of total revenue in the first six months of 2016. The increase is primarily due to lower software capitalization compared to the prior year period. In the six months ended June 30, 2017, we capitalized $566,000 of costs associated with software development projects compared to $1.1 million in the prior year period. We anticipate that research and development costs will increase in dollar amount in 2017 compared to 2016.

In the first quarter of 2016, the Company implemented restructuring plans in Canada. Because of these actions, restructuring charges of approximately $126,000 were recorded related to employee terminations. There were no restructuring charges recorded in the six months ended June 30, 2017.

Consolidated net income from operations was $323,000 and $520,000 in the three and six-month periods ended June 30, 2017, respectively, compared to a net income of $1.2 million and $901,000 in the comparable prior year periods. Consolidated net income per basic and diluted share were $0.06 and $0.10 for the three and six months ended June 30, 2017, respectively, compared to a net income of $0.24 and $0.18 for the three and six months ended June 30, 2016, respectively.

Liquidity and Capital Resources

At June 30, 2017, we had $2.7 million in cash and cash equivalents compared to $1.5 million in cash and cash equivalents at December 31, 2016.

Net cash provided by operating activities was $1.6 million in the first six months of 2017 compared to net cash used for operating activities of $427,000 in the same period in 2016. The primary reason for net cash provided by operating activities in the first six months of 2017 compared to the net cash used for operating activities for the same period in 2016 was the timing of the payment of outstanding payables and collection of receivables. We anticipate that average receivable collection days in 2017 will be similar to 2016 and that they will not have a material impact on our liquidity.

Net cash used for investing activities was $542,000 for the first six months of 2017 compared to net cash used for investing activities of $1.2 million in the same period in 2016. The decrease of the amount of net cash used for investing activities in the first six months of 2017 compared to the prior year period is the result of capitalized internal software development costs decreasing compared to the prior year period. At June 30, 2017, approximately $125,000 of capitalized software costs were in accounts payable. Our planned additions of property and equipment are discretionary, and we do not expect them to exceed historical levels in 2016.

In May 2014, the Company entered into a credit agreement and related documents with Alliance Bank which provided for a revolving line of credit for the Company. The credit agreement and related documents with Alliance Bank (collectively, the "Alliance Credit Agreement") provided up to a $5.0 million revolving line of credit bearing interest at a fixed annual rate of 3.95%. Any advances would have been secured by the Company's inventories, accounts receivable, cash, marketable securities, and equipment. We were subject to certain covenants under the Alliance Credit Agreement. In April 2016, we entered into an agreement with Alliance Bank amending the Alliance Credit Agreement to extend the maturity date from April 1, 2016 to May 12, 2017. We chose not to renew the Alliance Credit Agreement.

We believe that cash and cash equivalents on hand at June 30, 2017 and cash provided by operating activities will satisfy our projected working capital needs, investing activities, and other cash requirements for the foreseeable future.

Off-Balance Sheet Arrangements

We do not participate in transactions or have relationships or other arrangements with an unconsolidated entity, including special purpose and similar entities, or other off-balance sheet arrangements.

Critical Accounting Policies

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2016. The accounting policies used in preparing our interim Condensed Consolidated Financial Statements as of and for the three and six months ended June 30, 2017 are set forth elsewhere in this Quarterly Report on Form 10-Q and are the same as those described in our Annual Report on Form 10-K.

Cautionary Statement:

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange of 1934, as amended. Forward-looking statements represent our expectations or beliefs concerning future events and can be identified by the use of forward-looking words such as "expects," "believes," "may," "will," "should," "intends," "plans," "estimates," or "anticipates" or other comparable terminology. Forward-looking statements are subject to risks and uncertainties that may cause our actual results to differ materially from the results described in the forward-looking statements. Factors that might cause such differences include, but are not limited to:

- our historical dependence on a single product for most of our revenue;
- budget constraints by governmental entities that purchase our products, including constraints caused by declining tax revenue;
- the continuing ability of Econolite to pay royalties owed;

- the mix of and margin on the products we sell;
- our dependence on third parties for manufacturing and marketing our products;
- our dependence on single-source suppliers to meet manufacturing needs;
- our failure to secure adequate protection for our intellectual property rights;
- our inability to develop new applications and product enhancements;
- the potential disruptive effect on the markets we serve of new and emerging technologies and applications, including vehicle-to-vehicle communications and autonomous vehicles;
- unanticipated delays, costs and expenses inherent in the development and marketing of new products;
- our inability to respond to low-cost local competitors;
- our inability to properly manage any growth in revenue and/or production requirements;
- the influence over our voting stock by affiliates;
- our inability to hire and retain key scientific and technical personnel;
- the effects of legal matters in which we may become involved;
- our inability to achieve and maintain effective internal controls;
- our inability to successfully integrate acquisitions;
- political and economic instability, including continuing volatility in the economic environment of the European Union;
- our inability to comply with international regulatory restrictions over hazardous substances and electronic waste; and
- conditions beyond our control such as war, terrorist attacks, health epidemics and economic recession.

We caution that the forward-looking statements made in this report or in other announcements made by us are further qualified by the risk factors set forth in Item 1A. to our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our foreign sales and results of operations are subject to the impact of foreign currency fluctuations. From time to time, we enter into currency hedges to attempt to lower our exposure to translation gains and losses as well as to limit the impact of foreign currency translation upon the consolidation of our foreign subsidiaries. A 10% adverse change in foreign currency rates, if we have not properly hedged, could have a material effect on our results of operations or financial position.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of June 30, 2017, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the fiscal quarter covered by this Quarterly Report on Form 10-Q, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On May 5, 2016, Econolite, our exclusive North American manufacturer and distributor, served a complaint on us for a lawsuit filed by Econolite in the Superior Court of the State of California for the County of Orange. The complaint asserted claims against us under the Manufacturing, Distributing and Technology License Agreement, as amended, with Econolite (the "Econolite Agreement") for breach of contract and breach of implied covenant of good faith and fair dealing and sought specific performance related to the transition of North American RTMS sales and marketing activities from Econolite to us in July 2014. In the complaint, Econolite requested damages from us in an amount to be proven at trial and sought certain other remedies. On May 27, 2016, we removed the case to the Federal District Court, District of Central California. On November 15, 2016, Econolite and the Company entered into an Arbitration Agreement. On November 16, 2016, Econolite voluntarily dismissed all of its claims against the Company in the U.S. District Court but filed a demand for arbitration with JAMS (which is an alternative dispute resolution provider), asserting the same claims against the Company that it had asserted in the lawsuit. Arbitration commenced on November 16, 2016, and it remains ongoing. We believe that Econolite's claims are without merit, and we plan to vigorously defend against them. However, we cannot predict the outcome of this matter at this time or whether it will have a material adverse impact on our business prospects, financial condition, operating results or cash flow.

Item 1A. Risk Factors

Some of the risk factors to which we and our business are subject are described in the section entitled "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016. The risks and uncertainties described in our Annual Report are not the only risks we face. Additional risks and uncertainties not presently known to us or that our management currently deems immaterial also may impair our business operations. If any of the risks described were to occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

The following exhibits are filed as part of this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017:

Exhibit Number	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following financial information from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (Extensible Business Reporting Language), (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to Condensed Consolidated Financial Statements (filed herewith).

SIGNATURES

In accordance with 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.

	Image Sensing Systems, Inc.	
Dated: August 10, 2017	By:	/s/ Chad A. Stelzig Chad A. Stelzig President and Chief Executive Officer (Principal Executive Officer)
Dated: August 10, 2017	By:	/s/ Richard A. Ehrich Richard A. Ehrich Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

EXHIBIT INDEX

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