IMAGE SENSING SYSTEMS INC
Form 10-Q
August 09, 2018
Q2 false 10-Q 2018 0 Inventories, accounts receivable, cash, marketable securities, and equipment 0 No Smaller Reporting Company 2018-6-30 0000943034 IMAGE SENSING SYSTEMS INC Yes No --12-31 0000943034 isns:VisionDevelopmentCostsMember 2017-01-01 2017-12-31 0000943034 2017-12-31 0000943034 2017-06-30 0000943034 2017-04-01 2017-06-30 0000943034 2017-01-01 2017-06-30 0000943034 2017-01-01 2017-12-31 0000943034 isns:VisionDevelopmentCostsMember 2017-12-31 0000943034 isns:HighwayMember 2017-01-01 2017-06-30 0000943034 isns:HighwayMember 2017-06-30 0000943034 isns:HighwayMember 2017-04-01 2017-06-30 0000943034 isns:IntersectionMember 2017-04-01 2017-06-30 0000943034 us-gaap:RestrictedStockMember 2017-01-01 2017-06-30 0000943034 us-gaap:EmployeeStockOptionMember 2017-01-01 2017-06-30 0000943034 us-gaap:DevelopedTechnologyRightsMember 2017-12-31 0000943034 us-gaap:ComputerSoftwareIntangibleAssetMember 2017-12-31 0000943034 us-gaap:RevolvingCreditFacilityMember 2014-05-11 2014-05-12 0000943034 us-gaap:RevolvingCreditFacilityMember 2014-05-12 0000943034 isns:IntersectionMember 2017-06-30 0000943034 isns:IntersectionMember 2017-01-01 2017-06-30 0000943034 2016-12-31 0000943034 2018-07-31 0000943034 2018-01-01 2018-06-30 0000943034 2018-06-30 0000943034 2018-04-01 2018-06-30 0000943034 us-gaap:DevelopedTechnologyRightsMember 2018-06-30 0000943034 isns:VisionDevelopmentCostsMember 2018-06-30 0000943034 isns:VisionDevelopmentCostsMember 2018-01-01 2018-06-30 0000943034 us-gaap:ComputerSoftwareIntangibleAssetMember 2018-06-30 0000943034 isns:WrongWayDevelopmentCostsMember 2018-06-30 0000943034 isns:WrongWayDevelopmentCostsMember 2018-01-01 2018-06-30 0000943034 us-gaap:RevolvingCreditFacilityMember 2018-01-01 2018-06-30 0000943034 us-gaap:MinimumMember 2018-01-01 2018-06-30 0000943034 us-gaap:MaximumMember 2018-01-01 2018-06-30 0000943034 us-gaap:EmployeeStockOptionMember 2018-06-30 0000943034 us-gaap:EmployeeStockOptionMember 2018-01-01 2018-06-30 0000943034 us-gaap:RestrictedStockMember 2018-01-01 2018-06-30 0000943034 us-gaap:RestrictedStockMember 2018-06-30 0000943034 isns:IntersectionMember 2018-04-01 2018-06-30 0000943034 isns:HighwayMember 2018-04-01 2018-06-30 0000943034 isns:IntersectionMember 2018-06-30 0000943034 isns:HighwayMember 2018-06-30 0000943034 isns:IntersectionMember 2018-01-01 2018-06-30 0000943034 isns:HighwayMember 2018-01-01 2018-06-30 0000943034 us-gaap:EmployeeStockOptionMember 2018-04-01 2018-06-30 0000943034 us-gaap:EmployeeStockOptionMember 2017-04-01 2017-06-30 xbrli:shares xbrli:pure iso4217:USD iso4217:USD xbrli:shares

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, 2018 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 State or Other Jurisdiction of Incorporation or Organization	**41-1519168** I.R.S. Employer Identification No.
500 Spruce Tree Centre **1600 University Avenue West** **St. Paul, MN** Address of Principal Executive Offices	**55104** 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, 2018
Common Stock, $0.01 par value per share	5,269,809 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, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,690	$ 3,190
Accounts receivable, net of allowance for doubtful accounts of $24 and $20, respectively	2,974	3,339
Inventories	648	335
Prepaid expenses and other current assets	413	255
Total current assets	7,725	7,119
Property and equipment:		
Furniture and fixtures	163	164
Leasehold improvements	26	26
Equipment	1,044	998
	1,233	1,188
Accumulated depreciation	820	702
	413	486
Intangible assets, net	3,356	3,485
Deferred income taxes	36	38
TOTAL ASSETS	$ 11,530	$ 11,128
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 771	$ 563
Warranty	693	858
Accrued compensation	212	288
Other current liabilities	623	778
Total current liabilities	2,299	2,487
TOTAL LIABILITIES	2,299	2,487
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, 5,269,809 and 5,210,448 issued and outstanding at June 30, 2018 and December 31, 2017, respectively	52	51
Additional paid-in capital	24,467	24,355
Accumulated other comprehensive loss	(327)	(310)

Accumulated deficit	(14,961)	(15,455)
Total shareholders' equity	9,231	8,641
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 11,530	$ 11,128

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,	
	2018	**2017**	**2018**	**2017**
Revenue:				
Product sales	$ 1,376	$ 1,629	$ 2,220	$ 3,069
Royalties	2,517	1,846	4,683	3,490
	3,893	3,475	6,903	6,559
Cost of revenue:				
Product sales	609	708	964	1,252
Royalties	92	90	184	180
	701	798	1,148	1,432
Gross profit	3,192	2,677	5,755	5,127
Operating expenses:				
Selling, general and administrative	1,765	1,656	3,526	3,092
Research and development	916	728	1,735	1,544
	2,681	2,384	5,261	4,636
Operating income from operations	511	293	494	491
Other, net	—	30	—	33
Income from operations before income taxes	511	323	494	524
Income tax expense	—	—	—	4
Net income	$ 511	$ 323	$ 494	$ 520
Net income per share:				
Basic	$ 0.10	$ 0.06	$ 0.10	$ 0.10
Diluted	$ 0.10	$ 0.06	$ 0.10	$ 0.10
Weighted average number of common shares outstanding:				
Basic	5,206	5,117	5,194	5,107
Diluted	5,219	5,128	5,194	5,107

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		Six-Month Periods Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	$ 511	$ 323	$ 494	$ 520
Other comprehensive income (loss):				
Foreign currency translation adjustment	(16)	24	(17)	31
Comprehensive income	$ 495	$ 347	$ 477	$ 551

See accompanying notes to the condensed consolidated financial statements.

Image Sensing Systems, Inc.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

(in thousands)

	Six-Month Periods Ended June 30, 2018	2017
Operating activities:		
Net income	$ 494	$ 520
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	126	127
Software amortization	231	180
Stock-based compensation	123	153
Loss on disposal of assets	1	—
Changes in operating assets and liabilities:		
Accounts receivable, net	365	709
Inventories	(313)	(132)
Prepaid expenses and other current assets	(136)	(69)
Accounts payable	206	237
Accrued expenses and other current liabilities	(396)	(102)
Net cash provided by operating activities	701	1,623
Investing activities:		
Capitalized software development costs	(102)	(441)
Purchases of property and equipment	(79)	(101)
Net cash used for investing activities	(181)	(542)
Financing activities:		
Stock for tax withholding	(10)	—
Net cash used for financing activities	(10)	—
Effect of exchange rate changes on cash	(10)	28
Increase in cash and cash equivalents	500	1,109
Cash and cash equivalents at beginning of period	3,190	1,547
Cash and cash equivalents at end of period	$ 3,690	$ 2,656
Non-Cash investing and financing activities:		
Purchase of property and equipment in accounts payable	$ 2	$ 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, 2018

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, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. 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, 2017 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

On January 1, 2018, we adopted Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the full retrospective transition method. The Company's adoption of ASU 2014-09 did not have a material impact on the amount and timing of revenue recognized in its consolidated financial statements.

Under ASU 2014-09, we recognize revenue when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

We determine revenue recognition through the following steps:

- Identification of a contract, or contracts, with a customer;
- Identification of performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, we satisfy a performance obligation.

Revenue disaggregated by revenue source for the three and six months ended June 30, 2018 and 2017 consists of the following (in thousands). Revenue excludes sales and usage-based taxes where it has been determined that we are acting as a pass-through agent.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Product sales	$ 1,376	$ 1,629	$ 2,220	$ 3,069
Royalties	2,517	1,846	4,683	3,490
Total revenue	$ 3,893	$ 3,475	$ 6,903	$ 6,559

Product Sales:

Product revenue is generated from the direct sales of our RTMS radar systems worldwide and our Autoscope video systems in Europe and Asia. Revenue is recognized when control of the promised goods or services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

Certain product sales may contain multiple performance obligations for revenue recognition purposes. Multiple performance obligations may include the hardware, software, installation services, training, and support. In arrangements where we have multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. We generally determine stand-alone selling prices based on the observable stand-alone prices charged to customers. For performance obligations without observable stand-alone prices charged to customers, we evaluate the adjusted market assessment approach, the expected cost plus margin approach, and stand-alone sales to estimate the stand-alone selling prices.

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. Our payment terms may vary by the type and location of our customer and the products or services offered.

We record deferred revenues when cash payments are received or due in advance of our performance, including amounts which are refundable. The term between invoicing and when payment is due is not significant. For certain products or services and customer types, we require payment before the products or services are delivered to the customer.

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.

Royalties:

Econolite Control Products, Inc. (“Econolite”) is our licensee that sells our Autoscope video system 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.

Practical Expedients and Exemptions:

We generally expense sales commissions when incurred because the amortization periods would have been one year or less. These costs are recorded within sales and marketing expense.

We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

Inventories

Inventories are primarily electronic components and finished goods and are valued at the lower of cost or net realizable value 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 selling 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. Subsequent to reaching technological feasibility for certain software products in a prior quarter, we capitalized approximately $36,000 and $392,000 of software development costs during the quarters ended June 30, 2018 and 2017, 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, 2018 and December 31, 2017, we determined there was no impairment of intangible assets. At both June 30, 2018 and 2017, there were no indefinite-lived intangible assets.

Note B: Recent Accounting Pronouncements

Accounting pronouncements recently adopted

In May 2014, the Financial Accounting Standards Board (the "FASB") issued ASU 2014-09, which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605, Revenue Recognition (Topic 605). We adopted Topic 606 as of January 1, 2018 using the full retrospective transition method. See *Revenue Recognition* above for further details.

Accounting pronouncements not yet adopted

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 assessing the impact of ASU 2016-02 on the consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, "Compensation-Stock Compensation (Topic 718)". ASU 2018-07 largely aligns the accounting for share-based payment awards issued to employees and nonemployees by expanding the scope of ASC 718 to apply to nonemployee share-based transactions, as long as the transaction is not effectively a form of financing. The new guidance will be effective on January 1, 2019. We are currently evaluating the potential impact that ASU No. 2018-07 may have 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 $648,000 and $335,000 of finished goods as of June 30, 2018 and December 31, 2017, respectively.

Note E: Intangible Assets

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

	June 30, 2018			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life (in Years)
Developed technology	$ 3,900	$ (3,900)	$ —	—
Vision development costs	2,929	(636)	2,293	8.0
Software development in process costs	882	—	882	—
Wrong Way development costs	228	(47)	181	2.0
Total	$ 7,939	$ (4,583)	$ 3,356	7.6

	December 31, 2017			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life (in Years)
Developed technology	$ 3,900	$ (3,900)	$ —	—
Vision development costs	2,929	(452)	2,477	8.0
Software development in process costs	1,008	—	1,008	—
Total	$ 7,837	$ (4,352)	$ 3,485	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 2 to 5 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,	
	2018	2017
Beginning balance	$ 858	$ 1,223
Warranty provisions	80	26
Warranty claims	(18)	(74)
Adjustments to preexisting warranties	(222)	(107)
Currency	(5)	4
Ending balance	$ 693	$ 1,072

Note H: Stock-Based Compensation

We compensate officers, directors, key employees and consultants with stock-based compensation under the Image Sensing Systems, Inc. 2005 Stock Incentive Plan (the "2005 Plan") and the Image Sensing Systems, Inc. 2014 Stock Option and Incentive Plan (the "2014 Plan"), both of which were approved by our shareholders and administered under the supervision of our Board of Directors. Although stock options granted under the 2005 Plan are still outstanding, the 2005 Plan expired, and the Company can no longer grant options or other awards under the 2005 Plan. 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 3 to 5 years from the dates of the grant, beginning one year from the date of grant, and have a contractual term of 9 to 10 years.

Performance stock options are time based; however, the final number of awards earned and the related compensation expense are 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, 2018 and 2017 was $38,000 and $88,000, respectively. Stock-based compensation expense included in general and administrative expense for the six-month periods ended June 30, 2018 and 2017 was $123,000 and $153,000, respectively. At June 30, 2018, 129,304 shares were available for grant under the Company's 2014 Plan.

Stock Options

A summary of the option activity for the first six months of 2018 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, 2017	85,750	$ 5.78	4.00	$ —
Granted	—	$ —	—	$ —
Exercised	—	$ —	—	$ —
Expired	(8,000)	$ 6.12	—	$ —
Forfeited	(22,875)	$ 5.00	—	$ 363
Options outstanding at June 30, 2018	54,875	$ 6.06	3.44	$ —
Options exercisable at June 30, 2018	54,875	$ 6.06	3.44	$ —

There were no options exercised during the three and six-month periods ended June 30, 2018 and June 30, 2017. During the six-month periods ended June 30, 2018 and June 30, 2017, we recognized $1,000 and $11,000, respectively, of stock-based compensation expense related to stock options. As of June 30, 2018, there was no unrecognized compensation cost related to non-vested stock options.

Restricted Stock Awards and Stock Awards

Restricted stock awards are granted under the 2014 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. The restricted stock awards granted to executive officers vest 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 the time of vesting of the restricted stock awards, 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 to employees 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.

The following table summarizes restricted stock award activity for the first six months of 2018:

	Number of Shares		**Weighted Average Grant Date Fair Value**
Awards outstanding December 31, 2017	32,000	$	2.95
Granted	76,943		3.48
Vested	(34,732)		3.67
Forfeited	(15,334)		2.95
Awards outstanding at June 30, 2018	58,877	$	3.22

As of June 30, 2018, the total stock-based compensation expense related to non-vested awards not yet recognized was $169,000, which is expected to be recognized over a weighted average period of 2.6 years. The weighted average grant date fair value of restricted stock awards granted during the six-month period ended June 30, 2018 was $3.48. We granted restricted stock awards of 76,943 shares during the six-month period ended June 30, 2018. During the six-month periods ended June 30, 2018 and June 30, 2017, we recognized $122,000 and $142,000, respectively, of stock-based compensation expense related to restricted stock awards.

Note I: Income (loss) per Common Share

Net income (loss) per share is computed by dividing net income (loss) by the daily weighted average number of common shares outstanding during the applicable periods. Diluted net income (loss) per share includes the potentially dilutive effect of common shares subject to outstanding stock options and restricted stock awards using the treasury stock method. Under the treasury stock method, shares subject to certain outstanding stock options and restricted stock awards have been excluded from the diluted weighted average shares outstanding calculation because the exercise of those options or the vesting of those restricted stock awards would lead to a net reduction in common shares outstanding. As a result, stock options and restricted stock awards to acquire 50,919 and 107,247 weighted common shares have been excluded from the diluted weighted shares outstanding for the three-month periods ended June 30, 2018 and 2017, respectively, and 96,004 and 132,273 weighted common shares have been excluded from the diluted weighted shares outstanding for the six-month periods ended June 30, 2018 and 2017, respectively.

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

	Three-Month Periods Ended June 30, 2018	2017	Six-Month Periods Ended June 30, 2018	2017
Numerator:				
Net income	$511	$323	$ 494	$ 520
Denominator:				
Weighted average common shares outstanding	5,206	5,117	5,194	5,107
Dilutive potential common shares	13	11	—	—
Shares used in diluted net income per common share calculations	5,219	5,128	5,194	5,107
Basic net income per common share	$0.10	$0.06	$ 0.10	$ 0.10
Diluted net income per common share	$0.10	$0.06	$ 0.10	$ 0.10

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	
	2018	2017	2018	2017	2018	2017
Revenue	$ 2,842	$ 2,214	$ 1,051	$ 1,261	$ 3,893	$ 3,475
Gross profit	2,596	1,954	596	723	3,192	2,677
Amortization of intangible assets	92	90	28	—	120	90
Intangible assets	2,293	2,635	1,063	546	3,356	3,181

	Six Months Ended June 30,					
	Intersection		Highway		Total	
	2018	2017	2018	2017	2018	2017
Revenue	$ 5,259	$ 4,118	$ 1,644	$ 2,441	$ 6,903	$ 6,559
Gross profit	4,782	3,689	973	1,438	5,755	5,127
Amortization of intangible assets	184	180	47	—	231	180
Intangible assets	2,293	2,635	1,063	546	3,356	3,181

Note K: Restructuring and Exit Activities

In the third quarter of 2016, in order to streamline our operating and cost structure, we initiated the closure of our wholly-owned subsidiaries, Image Sensing Systems HK Limited (ISS HK) located in Hong Kong; Image Sensing Systems (Shenzhen) Limited (ISS WOFE) located in China; Image Sensing Systems Europe Limited (ISS Europe) located in the United Kingdom; Image Sensing Systems Europe Limited S.P.Z.O.O (ISS Poland) located in Poland; and Image Sensing Systems Germany, GmbH (ISS Germany) located in Germany. We incurred $3,000 of costs for entity closures in the three-month period ended June 30, 2018 with no costs incurred in the comparable prior year period.

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 GAAP, 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 any 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.

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

Overview

General.

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 an exclusive agreement 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 our 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.

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 any restructuring costs.

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 depreciating fixed assets and amortizing intangible assets, 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,	
	2018	2017	2018	2017
Income from operations	$ 511	$ 293	$ 494	$ 491
Adjustments to reconcile to non-GAAP income				
Amortization of intangible assets	120	90	231	180
Depreciation	63	62	126	127
Non-GAAP income from continuing operations	$ 694	$ 445	$ 851	$ 798

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 currently 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.

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**	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**
Revenue	$ 2,842	$ 2,214	$ 1,051	$ 1,261	$ 3,893	$ 3,475
Gross profit	2,596	1,954	596	723	3,192	2,677
Amortization of intangible assets	92	90	28	—	120	90
Intangible assets	2,293	2,635	1,063	546	3,356	3,181

	Six Months Ended June 30,					
	Intersection		**Highway**		**Total**	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**
Revenue	$ 5,259	$ 4,118	$ 1,644	$ 2,441	$ 6,903	$ 6,559
Gross profit	4,782	3,689	973	1,438	5,755	5,127
Amortization of intangible assets	184	180	47	—	231	180
Intangible assets	2,293	2,635	1,063	546	3,356	3,181

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,			
	2018		2017	
Product sales	35.3	%	46.9	%
Royalties	64.7		53.1	
Total revenue	100.0		100.0	
Gross profit - product sales	55.7		56.5	
Gross profit - royalties	96.3		95.1	
Selling, general and administrative	45.3		47.7	
Research and development	23.5		20.9	
Income from operations	13.1		9.3	
Income tax expense	—		—	
Net income	13.1		9.3	

	Six-Month Periods Ended June 30,			
	2018		2017	
Product sales	32.2	%	46.8	%
Royalties	67.8		53.2	
Total revenue	100.0		100.0	
Gross profit - product sales	56.6		59.2	
Gross profit - royalties	96.1		94.8	
Selling, general and administrative	51.1		47.1	
Research and development	25.1		23.5	
Income from operations	7.2		8.0	
Income tax expense	—		0.1	
Net income	7.2		7.9	

Total revenue increased to $3.9 million in the three-month period ended June 30, 2018, from $3.5 million in the same period in 2017, an increase of 12.0%, and increased to $6.9 million in the first six months of 2018, from $6.6 million in the same period in 2017, an increase of 5.2%. Royalty income increased to $2.5 million in the second quarter of 2018 from $1.8 million in the second quarter of 2017, an increase of 36.3%, and increased to $4.7 million in the first six months of 2018 from $3.5 million in the first six months of 2017, an increase of 34.2%. Product sales decreased to $1.4 million in the second quarter of 2018 from $1.6 million in the second quarter of 2017, a decrease of 15.5%, and decreased to $2.2 million in the first six months of 2018 from $3.1 million in the first six months of 2017, a decrease of 27.7%. The decrease in product sales resulted from lower volumes in all jurisdictions.

Revenue for the Intersection segment increased to $2.8 million in the three-month period ended June 30, 2018 from $2.2 million in the three-month period ended June 30, 2017, an increase of 28.4%. Revenue for the Intersection segment increased to $5.3 million in the first six months of 2018 from $4.1 million in the first six months of 2017, an increase of 27.7%. The increase can be primarily attributed to higher sales volumes by our partner, Econolite.

Revenue for the Highway segment decreased to $1.1 million in the three-month period ended June 30, 2018 from $1.3 million in the three-month period ended June 30, 2017, a decrease of 16.7%. Revenue for the Highway segment decreased to $1.6 million in the first six months of 2018 from $2.4 million in the first six months of 2017, a decrease of 32.7%. The decrease in revenue in the Highway segment is attributable to reduced product sales into all jurisdictions. Product sales gross profit for the Intersection product lines has historically been lower than gross profit for the Highway product lines and therefore the mix of the product lines sold in any given period can result in varying gross profit. Additionally, the geographic sales mix of our product sales can influence margins, as products sold in some jurisdictions have lower margins.

Gross profit for product sales decreased to 55.7% in the three months ended June 30, 2018 from 56.5% in the three months ended June 30, 2017. Product sales gross profit decreased $154,000, or 16.7%, in the three months ended June 30, 2018 compared to the prior year period. Gross profit for product sales decreased to 56.6% in the first six months of 2018 from 59.2% in the first six months of 2017. Product sales gross profit decreased $561,000 or 30.9% in the six months ended June 30, 2018 compared to the prior year period. The decrease in product gross margin percent in the six months ended June 30, 2018 is primarily due to a higher percentage of Autoscope video product sold during the period compared to the same period in the prior year. Additionally, the geographic sales mix of our product sales can influence margins, as product sold in some jurisdictions has higher margins.

Selling, general and administrative expense was $1.8 million, or 45.3% of total revenue, in the second quarter of 2018 compared to $1.7 million, or 47.7% of total revenue, in the second quarter of 2017, and increased to $3.5 million, or 51.1% of total revenue, in the first six months of 2018 compared to $3.1 million, or 47.1% of total revenue, in the first six months of 2017. The increase in expense in the second quarter of 2018 compared to the prior year period is primarily the result of increased sales and marketing costs related to a one-time severance accrual and recruiting fees for a new Vice President of Global Sales and Marketing that took place in the second quarter of 2018. The increase in expense in the first six months of 2018 is primarily a result of the severance and placement fees incurred in the second quarter 2018 as well as costs related to a semi-annual trade show, Intertraffic, that took place in the first quarter of 2018.

Research and development expense increased to $916,000, or 23.5% of total revenue, in the three-month period ended June 30, 2018 from $728,000, or 20.9% of total revenue ,in the three-month period ended June 30, 2017, and increased to $1.7 million or 25.1% of total revenue in the six months period ended June 30, 2018 from $1.5 million, or 23.5% of total revenue, in the six months period ended June 30, 2017. We capitalized $102,000 of costs associated with software development projects in the six-month period ended June 30, 2018 compared to capitalized software costs of $566,000 in the comparable prior year period.

Income tax expense of $4,000, or 0.1% of revenue, was recorded in the first six months of 2017. There was no income tax expense recorded in the first six months of 2018.

Consolidated net income was $511,000 and $494,000 in the three and six-month periods ended June 30, 2018, respectively, compared to net income of $323,000 and $520,000, respectively, in the comparable prior year periods. Consolidated net income per basic and diluted share was $0.10 and $0.10 for the three and six months ended June 30, 2018, respectively, compared to a net income per basic and diluted share of $0.06 and $0.10 for the three and six months ended June 30, 2017, respectively.

Liquidity and Capital Resources

At June 30, 2018, we had $3.7 million in cash and cash equivalents compared to $3.2 million in cash and cash equivalents at December 31, 2017.

Net cash provided by operating activities was $701,000 in the first six months of 2018 compared to net cash provided by operating activities of $1.6 million in the same period in 2017.

Net cash used for investing activities was $181,000 for the first six months of 2018 compared to net cash used for investing activities of $542,000 in the same period in 2017. The decrease of the amount of net cash used for investing activities in the first six months of 2018 compared to the prior year period is primarily the result of capitalized internal software development costs decreasing compared to the prior year period.

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, 2018 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, 2017. The accounting policies used in preparing our interim Condensed Consolidated Financial Statements as of and for the three and six months ended June 30, 2018 are set forth elsewhere in this Quarterly Report on Form 10-Q and should be read in conjunction with those described in our Annual Report on Form 10-K.

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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 any acquisitions;
- tariffs and other trade barriers;
- 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, 2017.

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 Interim 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 Interim Chief Financial Officer concluded that, as of June 30, 2018, 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

None.

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, 2017. 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.

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, 2018:

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 Interim 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 Interim 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, 2018, 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 9, 2018	By:	/s/ Chad A. Stelzig Chad A. Stelzig President and Chief Executive Officer (Principal Executive Officer)
Dated: August 9, 2018	By:	/s/ Todd C. Slawson Todd C. Slawson Interim Chief Financial Officer (Interim Principal Financial Officer and Interim Principal Accounting Officer)

EXHIBIT INDEX

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