INTELLIGENT SYSTEMS CORP
Form 10-Q
November 13, 2015

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report UNDER Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2015

OR

Transition Report UNDER Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _________ to ____________

Commission file number 1-9330

INTELLIGENT SYSTEMS CORPORATION

(Exact name of registrant as specified in its charter)

Georgia	**58-1964787**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4355 Shackleford Road, Norcross, Georgia	**30093**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(770) 381-2900**

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

Indicate by check mark whether the registrant has submitted electronically 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

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

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

As of October 31, 2015, 8,731,299 shares of Common Stock of the issuer were outstanding.

Intelligent Systems Corporation

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Ex. 32.1	Section 906 Certification of Chief Executive Officer and Chief Financial Officer
Ex.101.INS**	XBRL Instance
Ex.101.SCH**	XBRL Taxonomy Extension Schema
Ex.101.CAL**	XBRL Taxonomy Extension Calculation
Ex 101.DEF**	XBRL Taxonomy Extension Definitions
Ex.101.LAB**	XBRL Taxonomy Extension Labels
Ex.101.PRE**	XBRL Taxonomy Extension Presentation

** XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

Part I Financial Information

Item 1. Financial Statements

Intelligent Systems Corporation

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

As of	**September 30, 2015** (unaudited)	**December 31, 2014** (audited)
ASSETS		
Current assets:		
Cash	$ 18,580	$ 2,624
Marketable securities	394	463
Accounts receivable, net	963	501
Note and interest receivable	150	--
Other current assets	411	338
Assets from discontinued operations	--	3,012
Total current assets	20,498	6,938
Investments	1,664	1,605
Property and equipment, at cost less accumulated depreciation	661	581
Restricted cash, noncurrent portion	2,200	--
Other long-term assets	57	81
Total assets	$ 25,080	$ 9,205
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 176	$ 90
Deferred revenue, current portion	1,422	610
Accrued payroll	514	582
Accrued expenses	26	24
Other current liabilities	231	274
Liabilities from discontinued operations	181	838
Total current liabilities	2,550	2,418
Deferred revenue, net of current portion	151	191
Other long-term liabilities	--	18
Intelligent Systems Corporation stockholders' equity:		
Common stock, $0.01 par value, 20,000,000 shares authorized, 8,731,299 and 8,958,028 issued and outstanding at September 30, 2015 and December 31, 2014, respectively	87	90
Additional paid-in capital	20,869	21,537

Accumulated other comprehensive loss	(181)	(110)
Retained earnings (deficit)	4,330	(12,750)
Total Intelligent Systems Corporation stockholders’ equity	25,105	8,767
Noncontrolling interest	(2,726)	(2,189)
Total stockholders’ equity	22,379	6,578
Total liabilities and stockholders’ equity	$ 25,080	$ 9,205

The accompanying notes are an integral part of these consolidated financial statements.

Intelligent Systems Corporation

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except share and per share amounts)

	Three Months Ended Sept. 30, 2015	2014	Nine Months Ended Sept. 30, 2015	2014
Revenue				
Products	$139	$172	$413	$439
Services	1,093	937	3,096	2,745
Total net revenue	1,232	1,109	3,509	3,184
Cost of revenue				
Products	55	65	166	195
Services	603	481	1,774	1,371
Total cost of revenue	658	546	1,940	1,566
Expenses				
Marketing	58	72	180	227
General and administrative	433	243	1,527	776
Research and development	703	728	2,114	2,351
Loss from operations	(620)	(480)	(2,252)	(1,736)
Other income	46	4	74	137
Loss from continuing operations before income taxes	(574)	(476)	(2,178)	(1,599)
Income taxes	--	18	3	18
Loss from continuing operations	(574)	(494)	(2,181)	(1,617)
Gain (loss) on sale of discontinued operations, net of taxes	--	--	18,726	--
Income (loss) from discontinued operations, net of taxes	--	448	(3)	688
Net income (loss)	(574)	(46)	16,542	(929)
Net loss attributable to noncontrolling interest	150	211	538	642
Net income (loss) attributable to Intelligent Systems Corporation	$(424)	$165	$17,080	$(287)
Earnings (loss) per share attributable to Intelligent Systems Corporation:				
Basic				
Continuing operations	$(0.05)	$(0.03)	$(0.19)	$(0.11)
Discontinued operations	--	0.05	2.12	0.08
Earnings (loss) per share	$(0.05)	$0.02	$1.93	$(0.03)
Diluted				
Continuing operations	$(0.05)	$(0.03)	$(0.19)	$(0.11)
Discontinued operations	--	0.05	2.10	0.08
Earnings (loss) per share	$(0.05)	$0.02	$1.91	$(0.03)
Basic weighted average common shares outstanding	8,731,299	8,958,028	8,832,067	8,958,028
Diluted weighted average common shares outstanding	8,731,299	8,969,016	8,935,009	8,958,028
Net income (loss) attributable to Intelligent Systems Corporation:				

Loss from continuing operations	$(424)	$(283)	$(1,643)	$(975)
Income from discontinued operations	--	448	18,723	688
Net income (loss) attributable to Intelligent Systems Corporation	$(424)	$165	$17,080	$(287)

The accompanying notes are an integral part of these consolidated financial statements.

Intelligent Systems Corporation

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited, in thousands)

	Three Months Ended Sept. 30, 2015	Three Months Ended Sept. 30, 2014	Nine Months Ended Sept. 30, 2015	Nine Months Ended Sept. 30, 2014
Net income (loss)	$ (574)	$ (46)	$ 16,542	$ (929)
Other comprehensive income (loss):				
Foreign currency translation adjustments	3	6	(3)	4
Unrealized gain (loss) on available-for-sale marketable securities	(50)	(41)	(68)	(2)
Total comprehensive income (loss)	(621)	(81)	16,471	(927)
Comprehensive loss attributable to noncontrolling interest	150	211	538	642
Comprehensive income (loss) attributable to Intelligent Systems Corporation	$ (471)	$ 130	$ 17,009	$ (285)

The accompanying notes are an integral part of these consolidated financial statements.

Intelligent Systems Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

CASH PROVIDED BY (USED FOR):	**Nine Months Ended September 30, 2015**	**2014**
OPERATING ACTIVITIES:		
Net income (loss)	$16,542	$(929)
Income from discontinued operations	(18,723)	(688)
Net loss from continuing operations	(2,181)	(1,617)
Adjustments to reconcile net loss from continuing operations to net cash used for operating activities:		
Depreciation and amortization	168	117
Stock-based compensation expense	13	45
Investment income, net	--	(125)
Equity in (income) loss of affiliate company	21	(2)
Changes in operating assets and liabilities:		
Accounts receivable	(462)	338
Other current assets	(73)	(22)
Other long term assets	25	32
Accounts payable	86	42
Accrued payroll	(68)	(27)
Deferred revenue, current portion	812	(11)
Accrued expenses	2	36
Other current liabilities	(43)	(30)
Deferred revenue, net of current portion	(40)	--
Other long-term liabilities	(18)	(71)
Net cash used for operating activities	(1,758)	(1,295)
INVESTING ACTIVITIES:		
Purchase of marketable securities	--	(132)
Purchases of property and equipment	(248)	(136)
Advance on note receivable	(150)	--
Long-term investment	(80)	169
Net cash used for investing activities	(478)	(99)
FINANCING ACTIVITIES:		
Sale of capital stock pursuant to exercise of option	8	--
Repurchase of capital stock pursuant to tender offer	(692)	--
Net cash used for financing activities	(684)	--

Net cash provided by (used for) operating activities from discontinued operations	(204)	707
Net cash provided by (used for) investing activities from discontinued operations	19,082	(80)
Net cash provided by discontinued operations	18,878	627
Effects of exchange rate changes on cash	(2)	4
Net increase (decrease) in cash	15,956	(763)
Cash at beginning of period	2,624	3,433
Cash at end of period	$18,580	$2,670
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for income taxes	$--	$65

The accompanying notes are an integral part of these Consolidated Financial Statements.

Intelligent Systems Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Throughout this report, the terms “we”, “us”, “ours”, “ISC” and “company” refer to Intelligent Systems Corporation, includi its wholly-owned and majority-owned subsidiaries. The unaudited Consolidated Financial Statements presented in this Form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States applicable to interim financial statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of ISC management, these Consolidated Financial Statements contain all adjustments (which comprise only normal and recurring accruals) necessary to present fairly the financial position and results of operations as of and for the three and nine month periods ended September 30, 2015 and 2014. The interim results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year. These statements should be read in conjunction with our Consolidated Financial Statements and notes thereto for the fiscal year ended December 31, 2014, as filed in our Annual Report on Form 10-K/A.

2. *Sale of Subsidiary; Discontinued Operations* – On March 31, 2015, we and CRC Industries, Inc., a Pennsylvania corporation (“CRC”), entered into a Stock Purchase Agreement (the “Stock Purchase Agreement”) whereby we sold all of the issued and outstanding stock of our wholly owned subsidiary, ChemFree Corporation (“ChemFree”), to CRC (the “ChemFree Sale”). The purchase price for the all-cash sale was $21,600,000, subject to customary post-closing adjustments, including a working capital adjustment. The company retained all net cash of ChemFree as of the closing date. In the quarter ended March 31, 2015, the company recorded a gain on the sale of ChemFree of $18,746,000 and has retroactively classified the ChemFree operations as discontinued operations in all periods presented. The company intends to apply operating loss and capital loss carryforwards against the gain of sale and presently expects to incur an alternative minimum tax liability of approximately $181,000 on the transaction, which amount is included in liabilities of discontinued operations as of June 30, 2015. At the closing, a total of $3,300,000 of the purchase price was placed in escrow for purposes of securing our obligations to indemnify CRC and to refund a portion of the purchase price if ChemFree’s actual working capital amount on the closing date is less than the agreed upon target set forth in the Stock Purchase Agreement. Based on the initial post-closing working capital determination, we accrued $200,000 for a working capital adjustment, which amount was reflected in the gain on sale calculation reported in the Form 10-Q for the period ended March 31, 2015. In the quarter ended June 30, 2015, we expensed an additional $20,000 for the final working capital adjustment. In the quarter ended September 30, 2015, $880,000 that had been held as Restricted Cash – Current Portion related to the escrow was released to the company. The remaining escrow balance of $2,200,000, which will remain in escrow until September 30, 2016, is shown as Restricted Cash – Noncurrent Portion.

The following condensed financial information is provided for the ChemFree discontinued operations for the periods shown:

(unaudited, in thousands)	**Three Months Ended Sept. 30, 2015**	**2014**	**Nine Months Ended Sept. 30, 2015**	**2014**
Net sales	--	$2,678	$2,902	$7,967
Operating income (loss)	--	446	(3)	682
Net income before income taxes	--	456	6	708
Income taxes	--	8	9	20
Net income (loss) from discontinued operations	--	$448	$(3)	$688

The major components of the assets and liabilities of discontinued operations presented separately on the balance sheet are as follows:

(in thousands, unaudited)	**September 30, 2015**	**December 31, 2014**
Major classes of assets included as part of discontinued operations:		
Accounts receivable	$ --	$ 1,276
Inventories	--	1,042
Property, plant & equipment	--	488
Other assets	--	206
Total assets of discontinued operations	$ --	$ 3,012
Major classes of liabilities included as part of discontinued operations:		
Accounts payable	$ --	$ 190
Accrued payroll	--	152
Other current liabilities	181	284
Other liabilities	--	212
Total liabilities of discontinued operations	$ 181	$ 838

3. *Tender Offer Stock Repurchase* - On April 22, 2015, we commenced a modified "Dutch" auction style tender offer to purchase for cash shares of our common stock for an aggregate purchase price of no more than $5 million. The tender offer expired May 19, 2015. We accepted for tender 230,729 shares of common stock at a purchase price per share of $3.00 for an aggregate purchase price of $692,187. Shares repurchased were cancelled, resulting in a decline in the number of outstanding shares at September 30, 2015.

4. *Stock-based Compensation* - At September 30, 2015, we have three stock–based compensation plans in effect. We record compensation cost related to unvested stock option awards by recognizing the unamortized grant date fair value on a straight line basis over the service periods of each award. We have estimated forfeiture rates based on our historical experience. Stock option compensation expense is recognized as a component of general and administrative expenses in the accompanying Consolidated Financial Statements. We recorded $5,000 and $14,000 of stock-based compensation expense in the three months ended September 30, 2015 and 2014, respectively and $13,000 and $44,000 for the nine month periods ended September 30, 2015 and 2014, respectively. The estimated fair value of options granted is calculated using the Black-Scholes option pricing model with assumptions as previously disclosed in our 2014 Form 10-K/A.

As of September 30, 2015, there is $28,000 of unrecognized compensation cost related to stock options. During the nine month period ended September 30, 2015, an aggregate of 12,000 options were granted to three independent members of our board of directors pursuant to the 2011 Non-Employee Director Stock Option Plan (Director Plan). Pursuant to the terms of the Director Plan, the options were granted at fair value on the date of the Annual Shareholders meeting. During the nine month period ended September 30, 2015, 4,000 options were exercised and 12,000 options expired unexercised.

The following table summarizes stock options as of September 30, 2015:

	# of Shares	**Wgt Avg Exercise Price**	**Wgt Avg Remaining Contractual Life in Years**	**Aggregate Intrinsic Value**
Outstanding at September 30, 2015	274,500	$ 1.76	5.8	$ 329,280
Vested and exercisable at September 30, 2015	254,500	$ 1.72	5.5	$ 316,880

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the company's closing stock price on the last trading day of the third quarter of 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2015. The amount of aggregate intrinsic value will change based on the fair value of the company's stock.

5. *Fair Value of Financial Instruments* - The carrying value of cash, accounts receivable, accounts payable and certain other financial instruments (such as short-term borrowings, accrued expenses, and other current liabilities) included in the accompanying consolidated balance sheets approximates their fair value principally due to the short-term maturity of these instruments.

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash, marketable securities, and trade accounts. Our available cash is held in accounts managed by third-party financial institutions. Cash may exceed the Federal Deposit Insurance Corporation, or FDIC, insurance limits. While we monitor cash balances on a regular basis and adjust the balances as appropriate, these balances could be impacted if the underlying financial institutions fail. To date, we have experienced no loss or lack of access to our cash; however, we can provide no assurances that access to our cash will not be impacted by adverse conditions in the financial markets.

6. *Fair Value Measurements* - In determining fair value, the Company uses quoted market prices in active markets. GAAP establishes a fair value measurement framework, provides a single definition of fair value, and requires expanded disclosure summarizing fair value measurements. GAAP emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability.

GAAP establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable input be used when available. Observable inputs are based on data obtained from sources independent of the company that market participants would use in pricing the asset or liability. Unobservable inputs are inputs that reflect the company's assumptions about the estimates market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The hierarchy is measured in three levels based on the reliability of inputs:

• Level 1

Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments.

• Level 2

Valuations based on quoted prices in less active, dealer or broker markets. Fair values are primarily obtained from third party pricing services for identical or comparable assets or liabilities.

• Level 3

Valuations derived from other valuation methodologies, including pricing models, discounted cash flow models and similar techniques, and not based on market, exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections that are not observable in the market and significant professional judgment is needed in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Our available-for-sale investments are classified within level 1 of the valuation hierarchy.

The fair value of equity method and cost method investments has not been determined as it was impracticable to do so due to the fact that the investee companies are relatively small, early stage private companies for which there is no comparable valuation data available without unreasonable time and expense.

7. *Inventories* – Following the sale of our former ChemFree subsidiary on March 31, 2015, we no longer have any inventory.

8. *Concentration of Revenue* – In the three month periods ended September 30, 2015 and 2014, the two largest customers represented in aggregate 46 percent and 42 percent of consolidated revenue, respectively. In the nine month period ended September 30, 2015 and 2014, the two largest customers represented in aggregate 44 percent and 49 percent of consolidated revenue, respectively. Most of our customers have multi-year contracts with recurring minimum revenue as well as professional services fees, that vary by period depending on their business needs.

9. *Commitments and Contingencies* – Please refer to Note 8 to our Consolidated Financial Statements included in our 2014 Form 10-K/A for a description of our commitments and contingencies in addition to those disclosed herein. Effective April 1, 2015, we entered into a new lease for our U.S. operations. Accordingly, our future minimum lease payments for offices and data centers expiring at various dates through March 31, 2018 are as follows:

Year ended December 31,	
(in thousands)	
2015 (October 1 – December 31)	$68
2016	198
2017	158
2018	34
Total minimum lease payments	$458

In the ordinary course of business, from time to time we may be involved in various pending or threatened legal actions. The litigation process is inherently uncertain and it is possible that the resolution of such matters might have a material adverse effect upon our financial condition and/or results of operations.

10. *Industry Segment* – Following the sale of our ChemFree subsidiary, management considers our remaining subsidiaries, consisting of CoreCard and its affiliate companies, to be one operating segment. Historically, we have described this industry segment as Information Technology Products and Services but as our company and the financial software and services industries have evolved, we now consider the financial transaction solutions and services (“FinTech”) industry segment to be more appropriate.

11. *Income Taxes* – We recognize deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are recognized, net of a valuation allowance, for the estimated future tax effects of deductible temporary differences and tax credit carry-forwards. A valuation allowance against deferred tax assets is recorded when, and if, based upon available evidence, it is more likely than not that some or all deferred tax assets will not be realized.

There were no unrecognized tax benefits at September 30, 2015 and December 31, 2014. Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. There were no accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the periods presented. We have determined we have no uncertain tax positions.

We file a consolidated U.S. federal income tax return for all subsidiaries in which our ownership equals or exceeds 80%, as well as individual subsidiary returns in various states and foreign jurisdictions. With few exceptions we are no longer subject to U.S. federal, state and local or foreign income tax examinations by taxing authorities for years before 2011.

12. *Reclassification* – Certain prior year numbers related to the ChemFree subsidiary have been reclassified to conform to the current year presentation.

13. *Recent Accounting Pronouncements* – In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-8, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This guidance states that the disposal of a component of an entity is to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The pronouncement also requires additional disclosures regarding individually significant disposals of components that do not meet the criteria to be recognized as a discontinued operations as well as additional and expanded disclosures. ASU 2014-8 was effective for periods after December 15, 2014 and accordingly, we have prepared the Consolidated Financial Statements presented herein in accordance with this ASU.

We have considered all other recently issued accounting pronouncements and do not believe the adoption of such pronouncements will have a material impact on our Consolidated Financial Statements.

14. *Subsequent Event* – On October 28, 2015, Lancope, Inc., a technology company in which we hold a less than 1 percent equity interest, announced that it had agreed to be acquired by Cisco in a cash transaction valued at approximately $452 million. The transaction is scheduled to close within 90 days, subject to customary closing conditions including escrow provisions. At September 30, 2015, our carrying value for Lancope was $214,000. Based on preliminary information provided to us, if and when the transaction is completed, we would receive between $2.2 million and $2.5 million in total compensation. There can be no assurance, however, that the transaction will be concluded on the terms announced, or that it will be concluded at all. We are not aware of any other significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on our Consolidated Financial Statements.

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

In addition to historical information, this Form 10-Q may contain forward-looking statements relating to ISC. All statements, trend analyses and other information relative to markets for our products and trends in revenue, gross margins and anticipated expense levels, as well as other statements including words such as "anticipate", "believe", "plan", "estimate", "expect", and "intend", and other similar expressions, constitute forward-looking statements. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties including those factors described below under "Factors That May Affect Future Operations", and that actual results may differ materially from those contemplated by such forward-looking statements. ISC undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results.

For purposes of this discussion and analysis, we are assuming and relying upon the reader's familiarity with the information contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Form 10-K/A for the year ended December 31, 2014 as filed with the Securities and Exchange Commission.

Overview

The results reported reflect the effect of the sale of ChemFree subsidiary on March 31, 2015, as explained in more detail in Note 2 to the Consolidated Financial Statements. We have retroactively classified the ChemFree operations as discontinued operations in all periods presented. Our consolidated continuing operations consist primarily of the CoreCard Software subsidiary and its affiliate companies in Romania and India, as well as the corporate office which provides significant administrative, human resources and executive management support to CoreCard. Since the ChemFree subsidiary was our largest and most profitable operating company, our reported results for continuing operations will reflect significantly lower revenue and operating losses in the near-term.

CoreCard provides technology solutions and processing services to the financial services market, commonly referred to as the FinTech industry. We derive our product revenue from licensing our comprehensive suite of financial transaction management software to accounts receivable businesses, financial institutions, retailers and processors to manage their credit and debit cards, prepaid cards, private label cards, fleet cards, loyalty programs, and accounts receivable and small loan transactions. Our service revenue consists of fees for software maintenance and support for licensed software products, fees for processing services that we provide to companies that outsource their financial transaction processing functions to CoreCard, and professional services primarily for software customizations provided to both license and processing customers.

We have frequently recognized consolidated operating losses on a quarterly and annual basis and are likely to do so in the foreseeable future. CoreCard may report operating profits on an irregular basis and its results vary in part depending on the size and number of software licenses recognized in a particular period and the level of expenses incurred to support existing customers and development and sales activities. A significant portion of CoreCard’s expense is related to personnel, including approximately 200 employees located in India and Romania. In addition, CoreCard offers processing services as an alternative for customers who prefer to outsource this function instead of licensing our software and running the application in-house. We are likely to incur losses in the near future for the processing business because contract revenue is spread out over multi-year contracts while we are currently investing in the infrastructure, resources, processes and software features to support this developing business. In addition, we have certain corporate office expenses associated with being a public company that impact our operating results.

Our revenue fluctuates from period to period and our results are not necessarily indicative of the results to be expected in future periods. It is difficult to predict the level of consolidated revenue on a quarterly or annual basis for a number of reasons, including the following:

Software license revenue in a given period may consist of a relatively small number of contracts and contract values can vary considerably depending on the software product and scope of the license sold. Consequently, even minor delays in delivery under a software contract (which may be out of our control) could have a significant and unpredictable impact on the consolidated revenue that we recognize in a given quarterly or annual period.

Customers may decide to postpone or cancel a planned implementation of our software for any number of reasons, which may be unrelated to our software or contract performance, but which may affect the amount, timing and characterization of our deferred and/or recognized revenue.

Customers typically require our professional services to modify or enhance their CoreCard software implementation based on their specific business strategy and operational requirements, which vary from customer to customer and period to period.

The timing of new processing customer implementations is often dependent on third party approvals or processes which are typically not under our direct control.

The recent sale of the ChemFree operations has resulted in significant cash balances. We used $692,000 to repurchase shares of our common stock pursuant to a modified "Dutch" auction tender that ended on May 19, 2015. We intend to use cash balances to support the domestic and international operations associated with our CoreCard business and to expand our operations in the FinTech industry through financing the growth of CoreCard and, if appropriate opportunities become available, through acquisitions of businesses in this industry.

Results of Operations

The following discussion should be read in conjunction with the Consolidated Financial Statements and the notes to Consolidated Financial Statements presented in this quarterly report. The results for 2014 have been reclassified to reflect the former ChemFree subsidiary as a discontinued operation.

Revenue – Total revenue from continuing operations in the three and nine month periods ended September 30, 2015 was $1,232,000 and $3,509,000, respectively, which represent increases of 11 percent and 10 percent compared to the respective periods in 2014.

Revenue from products, which includes software license fees (and, in some cases monthly support fees when the license and support fees are bundled) was $139,000 and $413,000 in the three and nine month periods, respectively, ended September 30, 2015, compared to $172,000 and $439,000 in the same periods in 2014. Changes between periods generally reflect the timing of tier upgrade fees related to the number of accounts covered by certain software licenses.

Revenue from services was $1,093,000 and $3,096,000 in the three and nine month periods ended September 30, 2015, which represent an increase of 17 percent and 13 percent compared to the respective periods in 2014. Revenue from transaction processing services and professional services were both higher in the third quarter and year-to-date periods of 2015 as compared to the same periods in 2014 due to an increase in the number of customers and accounts on file for processing operations and more revenue was generated from professional services due to an increase in the number and value of professional services contracts completed in 2015. Maintenance revenue from annual contracts for technical and software support was higher in the third quarter of 2015 than in the same period last year. However, year-to-date maintenance revenue was lower in 2015 than in the corresponding period in 2014, due to the expiration of a contract in the second quarter of 2014. As expected, revenue from processing services continues to grow as CoreCard's customer base increases; however, the time required to implement new customer programs has taken longer than anticipated due to delays in third party integration and approval processes. It is not possible to predict with any accuracy the number and value of professional services contracts that CoreCard's customers will require in a given period. Customers typically request our professional services to modify or enhance their CoreCard software implementation based on their specific business strategy and operational requirements, which vary from customer to customer and period to period.

Cost of Revenue – Total cost of revenue was 53 percent and 55 percent of total revenue in the three and nine month periods ended September 30, 2015, respectively, compared to 49 percent in both of the corresponding periods in 2014.

Cost of product revenue as a percent of product revenue was 40 percent in the three and nine month periods ended September 30, 2015 as compared to 38 percent and 44 percent for the corresponding periods in 2014. Generally, the changes between periods are immaterial in amount and reflect the number of resources required to support our licensed customers, which may vary depending upon numerous factors such as the mix of new versus established customers.

Cost of service revenue as a percentage of total service revenue was 55 percent and 57 percent in the third quarter and year-to-date periods in 2015 compared to 51 percent and 50 percent in the corresponding periods in 2014. Cost of service revenue includes three components: costs to provide annual maintenance and support services to our installed base of licensed customers, costs to provide professional services, and costs to provide our financial transaction processing services. The cost and gross margins on such services can vary considerably from period to period depending on the customer mix, customer requirements and project complexity as well as the mix of our U.S. and offshore employees working on the various aspects of services provided. In addition, we continue to devote the resources necessary to support our developing processing business, including direct costs for regulatory compliance, infrastructure, network certifications, and customer support and currently expect these costs to continue to outpace processing revenue for the foreseeable future.

Operating Expenses – In the three and nine month periods ended September 30, 2015, total operating expenses from continuing operations were higher than in the corresponding periods in 2014. General and administrative expenses were significantly higher in the third quarter and year-to-date periods of 2015 than in the corresponding periods in 2014, mainly due to factors related to the sale of the ChemFree subsidiary. In 2014 a significant component of corporate G&A expenses was charged to our former ChemFree subsidiary for services provided by the corporate office to ChemFree and is included in the line item Income/Loss from Discontinued Operation. Following the sale of ChemFree in March 2015, corporate activities and resources (and the associated expense) have been re-focused on our continuing operations, primarily the CoreCard business and strategic initiatives, resulting in higher G&A expenses for continuing operations in 2015. In addition, the increase in G&A expenses for year-to-date 2015 includes bonuses paid following the ChemFree sale as well as transaction expenses for the tender offer. Research and development expenses were 14 percent lower in the third quarter of 2015 and 13 percent lower year-to-date 2015 compared to the corresponding periods last year, mainly due to more technical personnel expenses being charged to direct cost of services for maintenance, professional services and processing.

Gain on Sale of Discontinued Operations – As explained in more detail in Note 2 to the Consolidated Financial Statements, we recorded a gain of $18,726,000 on the sale of our ChemFree subsidiary in the year-to-date period of 2015.