INTELLIGENT SYSTEMS CORP
Form 10-Q
May 15, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2009

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 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 þ No o

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 o No o

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of April 30, 2009, 4,478,971 shares of Common Stock of the issuer were outstanding.

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Part I FINANCIAL INFORMATION
Item 1. Financial Statements

Intelligent Systems Corporation
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	March 31, 2009 *(unaudited)*	December 31, 2008
ASSETS		
Current assets:		
Cash	$ 588	$ 1,074
Accounts receivable, net	1,636	1,570
Notes and interest receivable, current portion	223	353
Inventories	966	1,051
Other current assets	270	280
Total current assets	3,683	4,328
Long-term investments	1,217	1,209
Notes and interest receivable, net of current portion	1,338	1,318
Property and equipment, at cost less accumulated depreciation	1,454	1,583
Other intangibles, net	256	268
Total assets	$ 7,948	$ 8,706
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 342	$ 325
Accounts payable	938	922
Deferred revenue	980	983
Accrued payroll	425	497
Accrued expenses and other current liabilities	950	970
Total current liabilities	3,635	3,697
Long-term liabilities, net of current portion	226	249
Commitments and contingencies (Note 8)		
Intelligent Systems Corporation stockholders equity:		
Common stock, $0.01 par value, 20,000,000 shares authorized, 4,478,971 shares issued and outstanding at March 31, 2009 and December 31, 2008	45	45
Additional paid-in capital	18,459	18,457
Accumulated other comprehensive loss	(105)	(92)
Accumulated deficit	(15,828)	(15,166)
Total Intelligent Systems Corporation stockholders equity	2,571	3,244
Noncontrolling interest [1]	1,516	1,516

Total stockholders equity		4,087		4,760
Total liabilities and stockholders equity	$	7,948	$	8,706

1. Prior year s data have been reclassified to conform to the current year s presentation reflecting the adoption of Statement of Financial Accounting Standards No.160.

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

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Intelligent Systems Corporation
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; in thousands, except share and per share amounts)

	Three Months Ended March 31, 2009	2008
Revenue		
Products	$ 2,485	$ 4,251
Services	303	96
Total revenue	2,788	4,347
Cost of revenue		
Products	1,318	2,386
Services	294	201
Total cost of revenue	1,612	2,587
Expenses		
Marketing	444	769
General & administrative	923	1,317
Research & development	504	808
Loss from operations	(695)	(1,134)
Other income (expense)		
Interest income (expense), net	15	(5)
Equity in income of affiliate company	7	26
Other income	12	
Loss from continuing operations before income taxes	(661)	(1,113)
Income taxes	1	12
Loss from continuing operations	(662)	(1,125)
Loss from discontinued operations		(362)
Net loss	$ (662)	$ (1,487)
Loss per share from continuing operations:		
Basic	$ (0.15)	$ (0.25)
Diluted	$ (0.15)	$ (0.25)
Loss per share from discontinued operations:		
Basic	$	$ (0.08)
Diluted	$	$ (0.08)
Loss per share:		
Basic	$ (0.15)	$ (0.33)
Diluted	$ (0.15)	$ (0.33)
Basic weighted average common shares outstanding	4,478,971	4,478,971

Diluted weighted average common shares outstanding	4,478,971	4,478,971

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

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Intelligent Systems Corporation
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

CASH PROVIDED BY (USED FOR):	Three Months Ended March 31, 2009	2008
OPERATIONS:		
Net loss	$ (662)	$ (1,487)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	124	126
Stock-based compensation expense	3	3
Non-cash interest income, net	(18)	
Equity in income of affiliate company	(7)	(26)
Changes in operating assets and liabilities		
Accounts receivable	(66)	(418)
Inventories	85	(46)
Other current assets	10	(390)
Accounts payable	16	164
Deferred revenue	(3)	236
Accrued payroll	(72)	(114)
Accrued expenses and other current liabilities	(20)	666
Other liabilities		(22)
Net cash used for operating activities	(610)	(1,308)
INVESTING ACTIVITIES:		
Proceeds from notes and interest receivable	129	119
Purchases of property and equipment	17	(131)
Net cash provided by (used for) investing activities	146	(12)
FINANCING ACTIVITIES:		
Borrowings under line of credit	240	1,400
Repayments made under line of credit	(223)	
Borrowings under notes payable		124
Payments on notes payable	(24)	(50)
Net cash provided by (used for) financing activities	(7)	1,474
Effects of exchange rate changes on cash	(15)	(5)
Net increase (decrease) in cash	(486)	149
Cash at beginning of period	1,074	554
Cash at end of period	$ 588	$ 703

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid during the period for interest	$	10	$	20
Cash paid during the period for income taxes		1		12

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

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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, including its wholly-owned and majority-owned subsidiaries.
2. 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 month periods ended March 31, 2009 and 2008. The interim results for the three months ended March 31, 2009 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, 2008, as filed in our Annual Report on Form 10-K.
3. *Reclassification* Certain prior period amounts have been reclassified to conform to the current period presentation. On January 1, 2009, we adopted Statement of Financial Accounting Standards No. 160 (SFAS No. 160) Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 , the provisions of which, among others, require that minority interests be renamed noncontrolling interests and be presented as a component of equity for all periods presented. Accordingly, $1,516,000 of minority interest which had been recorded in the liability section of the balance sheet at December 31, 2008 has been reclassified to stockholders equity for all periods presented.

We also reclassified shipping and handling amounts billed to customers from cost of sales to revenue totaling $271,000 for the three months ended March 31, 2008 to conform to our current period presentation. We classify shipping and handling amounts billed to customers in revenue and the cost of the shipping and handling to customers as a component of cost of sales.

4. *Discontinued Operations* As explained in more detail in Note 2 to the Consolidated Financial Statements included in our Form 10-K for the year ended December 31, 2008, effective April 16, 2008, the company and two subsidiaries, VISaer, Inc. and VISaer (U.K.) Limited (collectively, VISaer) completed the sale of substantially all the assets related to VISaer s business pursuant to the terms of an asset purchase agreement (the Asset Purchase Agreement) between IBS Technics, Inc. (IBS Technics) and VISaer. IBS Technics is a subsidiary of IBS Software Services, Inc., a software services company that had previously provided certain software development services to VISaer as an independent third party contractor. The VISaer business is presented as discontinued operations for all periods presented.

The following condensed financial information is provided for the VISaer discontinued operations for the periods shown.

	Three Months Ended March 31,	
(unaudited, in thousands)	**2009**	**2008**
Net sales	$	$ 628
Operating loss		(359)
Loss from discontinued operations		(361)

5. *Comprehensive Loss* In accordance with Financial Accounting Standards Board Statement No. 130, Reporting Comprehensive Income , comprehensive loss is the total of net loss and all other non-owner changes in equity in a period. A summary follows:

Consolidated Statements of Comprehensive Loss	Three Months Ended March 31,	
(unaudited, in thousands)	**2009**	**2008**
Net loss	$ (662)	$ (1,487)
Other comprehensive loss		

Foreign currency translation adjustment		(13)		(5)
Comprehensive loss	$	(675)	$	(1,492)

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6. *Stock-based Compensation* At March 31, 2009, we have two stock-based compensation plans in effect. In December 2004, the FASB issued FASB Statement No. 123R, Share-Based Payment (SFAS No. 123R) which replaced APB No. 25 and SFAS No. 123. We adopted SFAS No.123R effective January 1, 2006 using the modified prospective application method of adoption which requires us to record compensation cost related to unvested stock awards by recognizing the unamortized grant date fair value in accordance with provisions of SFAS 123R 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. As a result of adopting SFAS No. 123R, we recorded $3,000 of stock-based compensation expense in each of the three months ended March 31, 2009 and 2008.

The estimated fair value of options granted is calculated using the Black-Scholes option pricing model with assumptions as previously disclosed in our Form 10-K.

As of March 31, 2009, there is $10,000 of unrecognized compensation cost related to stock options. No options were granted, exercised or forfeited during the three months ended March 31, 2009. The following table summarizes options as of March 31, 2009:

	# of Shares		**Wgt Avg Exercise Price**	**Wgt Avg Remaining Contractual Life in Years**	**Aggregate Intrinsic Value**
Outstanding at March 31, 2009	221,000	$	2.46	4.2	
Vested and exercisable at March 31, 2009	203,000	$	2.37	3.7	

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 first quarter of 2009 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 March 31, 2009. At March 31, 2009, there were no in-the-money options and therefore no intrinsic value is reported. The amount of aggregate intrinsic value will change based on the fair market value of the company s stock.

7. *Concentration of Revenue* The following table indicates the percentage of consolidated revenue represented by each customer for any period in which such customer represented more than 10% of consolidated revenue.

	Three Months Ended March 31,	
(unaudited)	**2009**	**2008**
ChemFree Customer A	14%	14%
ChemFree Customer B		14%
ChemFree Customer C	35%	42%
ChemFree Customer D	13%	

8. *Commitments and Contingencies* Please refer to Note 9 to our Consolidated Financial Statements included in our 2008 Form 10-K for a description of our commitments and contingencies.

Legal Matters In December 2004, our ChemFree subsidiary filed a patent infringement action against J. Walter Co. Ltd. and J. Walter, Inc. in the United States Court for the Northern District of Georgia. The complaint alleges that certain of the defendants products infringe various U.S. patents held by ChemFree and seeks a ruling to compel the defendants to cease their infringing activities. The defendants have asserted various defenses. On May 8, 2009, a trial date of July 13, 2009 was set. While the resolution and timing of any legal action is not predictable, ChemFree believes it has sufficient grounds to prevail in these actions, although there can be no assurance that the disputes will be resolved in its favor. During the second and third quarter of 2008, several pre-trial rulings were made by the judge assigned to the case with respect to various motions submitted by ChemFree, J. Walter Co. Ltd. and J. Walter, Inc.

One of the rulings awarded ChemFree legal expenses related to a certain matter in an amount to be determined. Since the amount of the award has not been determined at this time, no amount for awarded legal expenses has been accrued in the accompanying Consolidated Financial Statements included in this filing.

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9. *Industry Segments* Segment information is presented consistently with the basis described in the 2008 Form 10-K. The following table contains segment information for continuing operations for the three months ended March 31, 2009 and 2008.

	Three Months Ended March 31,	
(unaudited, in thousands)	**2009**	**2008**
Information Technology		
Revenue	$ 343	$ 110
Operating loss	(579)	(1,077)
Industrial Products		
Revenue	2,445	4,237
Operating income	255	318
Consolidated Segments		
Revenue	2,788	4,347
Operating loss	(324)	(759)
Corporate expenses	(371)	(375)
Consolidated operating loss from continuing operations	$ (695)	$ (1,134)
Depreciation and Amortization		
Information Technology	$ 1	$ 34
Industrial Products	119	81
Consolidated segments	120	115
Corporate	4	6
Consolidated depreciation and amortization	$ 124	$ 121
Capital Expenditures		
Information Technology	$ (22)	$ 1
Industrial Products	3	123
Consolidated segments	(19)	124
Corporate	2	6
Consolidated capital expenditures	$ (17)	$ 130

(unaudited, in thousands)	**March 31, 2009**	**December 31, 2008**
Identifiable Assets		
Information Technology	$ 2,362	$ 2,600
Industrial Products	4,079	4,415
Consolidated segments	6,441	7,015
Corporate	1,507	1,691

Consolidated assets	$	7,948	$	8,706

10. *Income Taxes* Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. We have recognized tax benefits from all tax positions we have taken, and there has been no adjustment to any carry forwards (net operating loss or research and development credits) as a result of the implementation of FIN No. 48. The adoption of FIN No. 48 did not have a material effect on our consolidated financial position or results of operations. As of March 31, 2009, we do not have any unrecognized tax benefits and we do not anticipate any significant changes in the balance of unrecognized tax benefits during the next twelve months.

Our policy is to recognize accrued interest related to uncertain tax positions in interest expense and related penalties, if applicable, in general and administrative expense. No such interest expense or penalties were recognized during the three months ended March 31, 2009 and 2008.

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We file a consolidated U.S. federal income tax return for all subsidiaries in which our ownership exceeds 80 percent, as well as individual subsidiary returns in various states and foreign jurisdictions. Through April 15, 2008, our VISaer subsidiary filed a separate U.S. federal income tax return. For periods after April 15, 2008, we will include VISaer in our consolidated U.S. federal income tax return. 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 2003.

11. *New Accounting Pronouncements* In December 2007, the FASB issued Statement No. 160 (SFAS No. 160) Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 . SFAS No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and the deconsolidation of a subsidiary. It clarifies that the noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. It also changes the way the consolidated income statement is presented, requiring disclosure on the face of the income statement of the amount of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS No. 160 also establishes appropriate accounting for changes in a parent s ownership interest that do not result in deconsolidation and when a subsidiary is deconsolidated. SFAS No. 160 requires expanded disclosure to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Accordingly, we adopted SFAS No. 160 on January 1, 2009. The adoption of SFAS No. 160 resulted in the renaming of a minority interest totaling $1,516,000 which had previously been recorded in the liability section of the balance sheet to a noncontrolling interest presented as a component of stockholders equity for all periods presented.

In April 2008, the FASB issued FASB Staff Position FAS 142-3 (FSP 142-3), "Determination of the Useful Life of Intangible Assets . FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life for a recognized intangible asset under SFAS No. 142 and period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), Business Combinations , and other U.S. generally accepted accounting principles. FSP 142-3 will be effective beginning in fiscal year 2010. We are currently evaluating the impact that FSP 142-3 will have on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position FAS 141(R)-1 (FSP 141(R) -1), Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies . FSP 141(R)-1 modified SFAS No. 141(R) to provide that contingent assets acquired or liabilities assumed in a business combination be recorded at fair value if the acquisition-date fair value can be determined during the measurement period. If not, such items would be recognized at the acquisition date if they meet the recognition requirements of SFAS No. 5. In periods after the acquisition date, contingent assets and liabilities not recognized at the acquisition date shall be accounted for in accordance with applicable GAAP. This FSP has no immediate impact on our financial statements but will apply to any future acquisitions.

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.

12. *Subsequent Event* On April 17, 2009, we announced that we are planning to make a rights offering of common stock to our shareholders. Under the terms of the rights offering, we will distribute at no charge to the holders of our common stock non-transferable rights to purchase shares of our common stock. We will distribute one right for each share of common stock owned by such holder on the record date which is May 22, 2009. Each right will entitle the holder to purchase one share of our common stock at a subscription price of $.70 per share. Stockholders on the record date will also be entitled to subscribe, subject to allotment among all subscribing stockholders, for additional shares not subscribed for by other stockholders. A registration statement relating to the rights offering was filed with the Securities and Exchange Commission on April 17, 2009 but is not yet effective. Subject to the registration statement being declared effective, the rights offering is expected to commence of May 22, 2009 and expire on June 22, 2009. We expect to use proceeds from the rights offering primarily to support plans for our CoreCard subsidiary as well as other general working capital purposes.

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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 for the year ended December 31, 2008 as filed with the Securities and Exchange Commission.

Overview

Our consolidated subsidiaries operate in two industry segments: Information Technology Products and Services (Information Technology) and Industrial Products. The Industrial Products segment includes ChemFree Corporation (bio-remediating parts washers). The Information Technology sector consists of CoreCard Software, Inc. (CoreCard) (software for managing accounts receivables, credit and debit cards). As discussed in Note 4 to the Consolidated Financial Statements, we sold our VISaer business as of April 16, 2008. Accordingly, the Consolidated Financial Statements reported in this Form 10-Q and the discussion below do not include the results of our VISaer subsidiary as part of continuing operations.

We derive our product revenue from sales of software licenses in our Information Technology sector and sales and leases of equipment and supplies in our Industrial Products sector. Our service revenue consists of fees for implementation, consulting, training, maintenance and support for software products in our Information Technology sector. Our consolidated revenue is the aggregate of the revenue generated at our subsidiary companies. Our revenue fluctuates from period to period and our results are not necessarily indicative of the results to be expected in future periods. Period-to-period comparisons may not be meaningful and it is difficult to predict the level of consolidated revenue on a quarterly or annual basis for a number of reasons, including the following:

- A change in revenue level at one of our subsidiaries may impact consolidated revenue or be offset by an opposing change at another subsidiary.
- CoreCard has been involved in major new product development initiatives for a number of years and does not have extensive experience delivering and implementing our software products at customer sites, making it difficult to predict with certainty when it may recognize revenue on individual software contracts.
- 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 features or contract performance, but which may affect the amount, timing and characterization of our deferred and/or recognized revenue.
- Our subsidiaries are relatively small in revenue size and, in the Information Technology sector, revenue in a given period may consist of a relatively small number of contracts. Consequently, even small delays in a delivery under a software contract (which may be out of our control) could have a significant and unpredictable impact on consolidated revenue that we can recognize in a given quarterly or annual period.

Frequently we recognize consolidated operating losses on a quarterly and annual basis and are likely to do so in the future from time to time. Our operating expenses consist of the aggregate of our subsidiaries expenses and the corporate office expenses. Our ChemFree subsidiary generates an operating profit on a regular basis but our earlier stage subsidiary, CoreCard, is not consistently profitable, mainly due to significant research and development expense that is invested to complete new product offerings and the deferral of revenue recognition until such products are delivered to and accepted by customers. Depending upon the size and number of software licenses recognized in a particular period and the level of expenses incurred to support development and sales activities, CoreCard may report operating profits on an irregular basis as it builds its customer base. A significant portion of our subsidiaries expense is related to personnel. For these and other reasons, our operating profits or losses may vary from quarter to quarter and at the present time are generally not predictable with any degree of certainty.

From time to time, we also generate income or incur losses from non-operating sources and we may do so in the future. We may derive income from sales of holdings in subsidiary, affiliate and other minority-owned companies, as exemplified in the VISaer sale, discussed in more detail in Note 4 to the Consolidated Financial Statements. Occasionally, we record a charge if we believe the value of a non-consolidated company is impaired. We also recognize on a quarterly basis our pro rata share of the income or losses of our affiliate company accounted for by the equity method. The timing and amount of gain or loss recognized as a result of a sale or the amount of equity in the income or losses of affiliate generally are not under our control and are not necessarily indicative of future results, either on a quarterly or annual basis.

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.

Revenue Total revenue from continuing operations in the three month period ended March 31, 2009 was $2.8 million, a 36 percent decrease compared to the first quarter of 2008.

Revenue from products, which includes sales and leases of equipment and supplies in our Industrial Products segment as well as software license fees related to the Information Technology segment, was $2.5 million in the three month period ended March 31, 2009, a 42 percent decline compared to $4.3 million in the three months ended March 31, 2008. The decline in product revenue in the first quarter of 2009 compared to the prior year is primarily associated with a decline in domestic sales of ChemFree equipment (our Industrial Products segment) due to the fact that in the first quarter of last year, a new customer was in the middle of a national program to sell ChemFree products to its installed customer base, resulting in a high initial volume of sales. With the initial rollout complete, the number of new machines sold to this customer in the first quarter of 2009 was lower than during the rollout period last year. Sales of ChemFree s fluid and filter consumables in the domestic market increased significantly in the three month period of 2009 compared to 2008, reflecting an increasing base of domestic users of its SmartWasher® part washers. There was a period-to-period decline in international sales of equipment and fluid, reflecting the general economic slowdown in certain European markets as well as changes in distributor requirements from period to period. Software license revenue associated with the Information Technology segment increased in the three month period ended March 31, 2009 compared to the three month period ended March 31, 2008 but was not a significant contributor to product revenue in either period. The company recognizes software license revenue generally upon completion of each contract and acceptance by customers.

Service revenue associated with the Information Technology segment was $303,000 in the first quarter of 2009, more than double the level reported in the same period in 2008. The change is attributed mainly to increased professional services projects that were completed for CoreCard customers as well as an increase in our installed base of customers that pay for maintenance and technical support.

Due to general economic conditions and uncertainty about the impact of a slowing economy on the automotive repair and supplies industry, ChemFree is planning for a relatively flat volume of machine sales for the foreseeable future and is carefully managing its costs and inventory levels accordingly. We expect that sales of replenishment fluid and filter the installed base of customers and lease revenue will be relatively unaffected by fluctuations in general economic conditions. Turmoil in the global financial markets could impact CoreCard s revenue and prospects in the foreseeable future if customers or prospects postpone software purchases or implementations. We are carefully monitoring the evolving dynamics in the marketplace and proactively lowered expenses going into 2009. We expect to support existing customers and contracts and to continue to add new prospects and customers as opportunities arise in these uncertain times.

Cost of Revenue Total cost of revenue was 58 percent of total revenue in the three month period ended March 31, 2009 compared to 60 percent of total revenue in the first quarter of 2008. The improvement is related principally to favorable changes in ChemFree s product mix from period to period as well as increased services revenue and lower costs to deliver services at CoreCard.

Cost of product revenue was 53 percent and 56 percent of product revenue in the three months ended March 31, 2009 and 2008, respectively. Higher margin fluid and filters represented a larger percentage of product revenue in the first quarter of 2009 than in the comparable period in 2008, resulting in an improved gross margin.

Cost of service revenue (which relates to our software business only) was significantly lower as a percent of service revenue in the three month period ended March 31, 2009 compared to the same period last year. The mix of service revenue in a given period, as well as the number of customers and new products being supported, impacts the gross margin on service revenue. CoreCard is providing a high level of support to its initial customers to ensure it builds a solid base of reference customers and puts in place an infrastructure for future growth. Cost of providing routine maintenance and support services as a percentage of service revenue is expected to decrease as CoreCard s installed base of customers increases, whereas the cost of professional services as a percent of revenue is expected to have a relatively stable gross margin percentage from period to period.

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Operating Expenses In the three month period ended March 31, 2009, total consolidated operating expenses were 36 percent lower than in the corresponding period in 2008. Consolidated marketing expenses declined 42 percent in the three month period in 2009 compared to the same period in 2008 mainly due to lowers sales commissions paid by ChemFree and a reduction in personnel related expenses. Consolidated general and administrative expenses were 30 percent lower in the first quarter of 2009 compared to the first quarter of 2008, reflecting mainly reduced legal expenses and personnel-related expenses. Consolidated research and development expenses were 38 percent lower in the first quarter of 2009 compared to the same period last year, mainly due to a reduction in consulting fees and personnel-related expenses associated with our CoreCard business.

Interest Income (Expense), net We recorded net interest income of $15,000 and net interest expense of $5,000 in the three months ended March 31, 2009 and 2008, respectively. The difference between periods reflects primarily the net effect of periodic fluctuations in our bank borrowings and notes receivable balances.

Equity in Income of Affiliate Company On a quarterly basis, we recognize our pro rata share of the earnings or losses of our affiliate company that we record on the equity method. We recorded $7,000 and $26,000 in net equity income of our affiliate company in the three months ended March 31, 2009 and 2008. The change between periods reflects a decline in profitability of the affiliate company.

Other Income We recorded $12,000 of other miscellaneous income items in the three months ended March 31, 2009.

Income Taxes We recorded $1,000 in the three month period ended March 31, 2009 for income tax expense. We believe our net deferred tax assets should be fully reserved at March 31, 2009 given their character and our historical losses. Accordingly, no deferred tax assets have been recorded at March 31, 2009.

Discontinued Operations

Loss from Discontinued Operations The amounts recorded in 2008 reflect the operations of our VISaer subsidiary which has been classified as a discontinued operation as a result of the sale of the VISaer business as explained in Note 4 to the Consolidated Financial Statements.

Liquidity and Capital Resources

Our cash balance at March 31, 2009 was $588,000 compared to a cash balance of $1,074,000 at December 31, 2008. During the three months ended March 31, 2009, we used $581,000 cash for operations, principally to support our corporate office, CoreCard and our international R&D operations. Our principal sources of cash were $109,000 in payments received on notes receivable and net borrowings of $16,000 under our line of credit.

We have a bank line of credit with a maximum availability of $1.25 million based on qualifiying accounts receivable and inventory levels which we use from time to time to support short-term cash needs. We presently project that we will have sufficient accounts receivable and inventory balances for the foreseeable future to support the borrowing base for any required draws under our bank line of credit. However, the line expires on June 30, 2009, subject to the bank renewing the line for an additional period. There can be no assurance that the line of credit will be renewed on terms acceptable to the company, if at all.

In the fourth quarter of 2008, due to uncertainty regarding general economic and financial market conditions and the extent to which customer buying decisions in the near-term would be impacted (both for ChemFree and CoreCard), the company implemented cost reduction measures including reductions in payroll expense and discretionary spending. We also explored the possibility of raising additional capital in order to (i) accelerate and support our CoreCard subsidiary s marketing initiatives, product development and prepaid card services rollout and (ii) increase our shareholders equity as part of a plan to regain compliance with the continued listing standards of the NYSE Amex. After considering a number of alternatives, on April 17, 2009, we announced plans to make a rights offering of common stock to our shareholders. Under the terms of the rights offering, subject to the effectiveness of a registration statement that we have filed with the Securities and Exchange Commission, we will distribute at no charge to the holders of our common stock non-transferable rights to purchase one share of our common stock for each share they own on the record date at a price of $.70 per share. Stockholders as of the record date will also be entitled to subscribe for additional shares not subscribed for by other shareholders.

While the amount of cash proceeds from the rights offering will depend upon the participation of our shareholders and is not determinable in advance, we believe the proceeds from the rights offering will be sufficient to fund our operations and plans for the foreseeable future. However, there can be no assurance that the offering will meet our expectations or requirements. Furthermore, if our line of credit is not renewed, we would be required to repay the principal outstanding which would reduce the funds available from the offering proceeds. Furthermore, if we fail to control costs, if we fail to meet software delivery commitments, if anticipated customer payments are delayed for any reason, if we encounter unforeseen delays in product development or production, we could require more cash than planned. As a result, we may need to seek additional financing or scale back operations.

Long-term, we currently expect that liquidity will continue to improve and consolidated operations will generate sufficient cash to fund their requirements with use of our credit facility if necessary to accommodate short-term needs. Other long-term sources of liquidity include potential sales of investments or subsidiaries although the timing and amount of any such transactions are uncertain and, to the extent they involve non-consolidated companies, generally not within our control.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements that are reasonably likely to have a current or future material effect on our financial condition, liquidity or results of operations.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We consider certain accounting policies related to revenue recognition, valuation of acquired intangibles and impairment of long-lived assets, and valuation of investments to be critical policies due to the estimation processes involved in each. Management discusses its estimates and judgments with the Audit Committee of the Board of Directors. For a detailed description on the application of these and other accounting policies, see Note 1 to the Consolidated Financial Statements contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Reference is also made to the discussion of the application of these critical accounting policies and estimates contained in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for 2008. Except as explained in Note 3 to the Consolidated Financial Statements, during the three month period ended March 31, 2009, there were no significant or material changes in the application of critical accounting policies that would require an update to the information provided in the Form 10-K for 2008.

Factors That May Affect Future Operations

Future operations in both the Information Technology Products and Services and Industrial Products segments are subject to risks and uncertainties that may negatively impact our future results of operations or projected cash requirements. It is difficult to predict future quarterly and annual results with certainty. Any trend or delay that affects even one of our subsidiaries could have a negative impact on the company s consolidated results of operations or cash requirements on a quarterly or annual basis. In addition, the carrying value of our investments is impacted by a number of factors which are generally beyond our control since we are typically a non-controlling shareholder in a private company with limited liquidity.

Among the numerous factors that may affect our consolidated results of operations or financial condition are the following:

- Turmoil in the global financial markets could have a serious negative impact on CoreCard due to potential customers (most of whom are financial institutions or services firms) delaying purchase or implementation decisions.
- Reluctance by financial institutions to act as sponsor banks for prospective customers (such as issuers and processors of credit and prepaid cards) could increase CoreCard s losses and cash requirements.
- It is unclear to what extent the downturn in the domestic US economy could impact the automotive parts and repair industry and reduce demand for ChemFree s SmartWasher® products.

Delays in software development projects could cause our customers to delay implementations or delay payments, which would increase our costs and reduce our revenue.

Our CoreCard subsidiary could fail to deliver software products which meet the business and technology requirements of its target markets within a reasonable time frame and at a price point that supports a profitable, sustainable business model.

One of ChemFree s customers represented approximately 35 percent of our consolidated revenue in the first quarter of 2009 and any unplanned changes in the volume of orders or timeliness of payments from such customer could have a negative impact on inventory levels and cash, at least in the near-term.

Failure by ChemFree to protect its intellectual property assets could increase competition in the marketplace and result in greater price pressure and lower margins, thus potentially impacting sales, profits and projected cash flows.

Software errors or poor quality control may delay product releases, increase our costs, result in non-acceptance of our software by customers or delay revenue recognition.

Compliance with the internal control over financial reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002 could increase operating expenses and divert management and staff resources.

Competitive pressures (including pricing, changes in customer requirements and preferences, and competitor product offerings) may cause prospective customers to choose an alternative product solution, resulting in lower revenue and profits (or increased losses).

CoreCard could fail to establish a base of reference customers for its new product offerings, resulting in lower revenue and profits (or increased losses), increased cash needs and possibly leading to restructuring or cutting back of the subsidiary s operations.

In certain limited situations, ChemFree lease customers are permitted to terminate the lease covering a SmartWasher® machine, requiring the unamortized balance of the original machine cost to be written off which could reduce profits in that reporting period and result in lower revenue in future periods.

CoreCard could fail to retain key software developers and managers who have accumulated years of know-how in our target markets and company products, or fail to attract and train a sufficient number of new software developers and testers to support our product development plans and customer requirements at projected cost levels.

Delays in anticipated customer payments for any reason would increase our cash requirements and possibly our losses.

Declines in performance, financial condition or valuation of minority-owned companies could cause us to write-down the carrying value of our investment or postpone an anticipated liquidity event, which could negatively impact our earnings and cash flow.

Failure to meet the continued listing standards of NYSE Alternext U.S. could result in delisting of our common stock, with a potentially negative impact on market price and liquidity of our common stock.

Other general economic and political conditions could cause customers to delay or cancel software purchases.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the company carried out an evaluation, under the supervision and with the participation of the company s management, including the company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the company s disclosure controls and procedures pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the company s disclosure controls and procedures are effective. There were no significant changes in the company s internal control over financial reporting or in other factors identified in connection with this evaluation that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the company s internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as described in Note 8 to the Consolidated Financial Statements, we are not currently subject to any material legal proceedings. However, from time to time, we may become a party to certain legal proceedings in the ordinary course of business. As of March 31, 2009, we do not believe any ongoing legal proceedings will have a material adverse effect on our consolidated financial position or results of operations.

Item 6. Exhibits

The following exhibits are filed or furnished with this report:

3.1	Amended and Restated Articles of Incorporation of the Registrant dated November 14, 1991, as amended November 25, 1997. (Incorporated by reference to Exhibit 3.1 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 1991 and to Exhibit 3.1 to the Registrant s Report on Form 8-K dated November 25, 1997.)
3.2	Bylaws of the Registrant dated December 7, 2007. (Incorporated by reference to Exhibit 3.2 of the Registrant s Form 8-K dated December 7, 2007.)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer furnished as required by Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

	INTELLIGENT SYSTEMS CORPORATION Registrant
Date: May 15, 2009	By: */s/ J. Leland Strange* J. Leland Strange Chief Executive Officer, President
Date: May 15, 2009	By: */s/ Bonnie L. Herron* Bonnie L. Herron Chief Financial Officer

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EXHIBIT INDEX

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