INTELLIGENT SYSTEMS CORP
Form 10-Q
May 14, 2010

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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, 2010

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

Indicated by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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, 2010, 8,958,028 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 and per share amounts)

	March 31, 2010 (unaudited)	December 31, 2009 (audited)
ASSETS		
Current assets:		
Cash	$ 2,463	$ 2,795
Accounts receivable, net	1,923	1,680
Notes and interest receivable, current portion	501	492
Inventories, net	780	964
Other current assets	527	399
Total current assets	6,194	6,330
Long-term investments	1,206	1,219
Notes and interest receivable, net of current portion	1,019	1,006
Property and equipment, at cost less accumulated depreciation	1,269	1,256
Patents, net	211	223
Total assets	$ 9,899	$ 10,034
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 550	$ 576
Deferred revenue	1,122	1,355
Accrued payroll	497	423
Accrued expenses	526	565
Other current liabilities	391	406
Total current liabilities	3,086	3,325
Long-term liabilities	92	100
Commitments and contingencies (Note 7)		
Intelligent Systems Corporation stockholders equity:		
Common stock, $0.01 par value, 20,000,000 shares authorized, 8,958,028 issued and outstanding at March 31, 2010 and December 31, 2009	90	90
Additional paid-in capital	21,413	21,410
Accumulated other comprehensive loss	(4)	(28)
Accumulated deficit	(16,294)	(16,379)
Total Intelligent Systems Corporation stockholders equity	5,205	5,093
Non-controlling interest	1,516	1,516

Total stockholders equity		6,721		6,609
Total liabilities and stockholders equity	$	9,899	$	10,034

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, 2010	2009
Revenue		
Products	$ 3,347	$ 2,485
Services	350	303
Total revenue	3,697	2,788
Cost of revenue		
Products	1,709	1,318
Services	174	294
Total cost of revenue	1,883	1,612
Expenses		
Marketing	566	444
General & administrative	725	923
Research & development	437	504
Income (loss)	86	(695)
Other income (expense)		
Interest income, net	27	15
Equity in income (loss) of affiliate company	(12)	7
Other income	6	12
Income (loss) before income taxes	107	(661)
Income taxes	23	1
Net income (loss)	$ 84	$ (662)
Income (loss) per share:		
Basic	$ 0.01	$ (0.15)
Diluted	$ 0.01	$ (0.15)
Basic weighted average common shares outstanding	8,958,028	4,478,971
Diluted weighted average common shares outstanding	8,962,767	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)

	Three Months Ended March 31,	
CASH PROVIDED BY (USED FOR):	**2010**	**2009**
OPERATIONS:		
Net income (loss)	$ 84	$ (662)
Adjustments to reconcile net income (loss) to net cash used for operating activities:		
Depreciation and amortization	129	124
Stock-based compensation expense	3	3
Non-cash interest income, net	(18)	(18)
Equity in (income) loss of affiliate company	12	(7)
Changes in operating assets and liabilities		
Accounts receivable	(243)	(66)
Inventories	186	85
Other current assets	(128)	10
Accounts payable	(26)	16
Deferred revenue	(233)	(3)
Accrued payroll	74	(72)
Accrued expenses	(39)	(20)
Net cash used for operating activities	(199)	(610)
INVESTING ACTIVITIES:		
Proceeds from notes and interest receivable	(2)	129
Dispositions (purchases) of property and equipment	(130)	17
Net cash provided by (used for) investing activities	(132)	146
FINANCING ACTIVITIES:		
Borrowings under line of credit		240
Repayments made under line of credit		(223)
Payments on notes payable	(26)	(24)
Net cash used for financing activities	(26)	(7)
Effects of exchange rate changes on cash	25	(15)
Net decrease in cash	(332)	(486)
Cash at beginning of period	2,795	1,074
Cash at end of period	$ 2,463	$ 588

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 2	$ 10
Cash paid during the period for income taxes	20	1

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, 2010 and 2009. The interim results for the three months ended March 31, 2010 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, 2009, as filed in our Annual Report on Form 10-K.
3. *Comprehensive Income (Loss)* Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in equity in a period. A summary follows:

Consolidated Statements of Comprehensive Income (Loss)	**Three Months Ended March 31,**			
(unaudited, in thousands)		**2010**		**2009**
Net income (loss)	$	84	$	(662)
Other comprehensive loss				
Foreign currency translation adjustment		24		(13)
Comprehensive income (loss)	$	108	$	(675)

4. *Stock-based Compensation* At March 31, 2010, we have two stock-based compensation plans in effect. We record compensation cost related to unvested stock awards by recognizing the unamortized grant date fair value on a straight line basis over the vesting periods of each award. We have estimated forfeiture rates based on our historical experience. Stock option compensation expense for the periods ended March 31, 2010 and 2009 has been recognized as a component of general and administrative expenses in the accompanying Consolidated Financial Statements. We recorded $3,000 of stock-based compensation expense in each of the quarters ended March 31, 2010 and 2009.

The estimated fair value of options granted is calculated using the Black-Scholes option pricing model with assumptions as previously disclosed in our 2009 Form 10-K.

As of March 31, 2010, there is $3,000 of unrecognized compensation cost related to stock options. No options were granted, exercised or forfeited during the three months ended March 31, 2010. The following table summarizes options as of March 31, 2010:

	# of Shares		**Wgt Avg Exercise Price**	**Wgt Avg Remaining Contractual Life in Years**		**Aggregate Intrinsic Value**
Outstanding at March 31, 2010	233,000	$	2.37	3.5	$	6,000
Vested and exercisable at March 31, 2010	215,000	$	2.44	3.0		

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 2010 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, 2010. The amount of aggregate intrinsic value will change based on the fair market value of the company s stock.

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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. The carrying value of non-interest bearing notes receivable beyond one year have been discounted at a rate of 6% which approximates rates offered in the market for notes receivable with similar terms and conditions. The fair value of equity method and cost method investments has not been determined as it was impracticable to do so.

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash, trade accounts and notes receivable. 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. *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)	**2010**	**2009**
ChemFree Customer A	12%	14%
ChemFree Customer B	35%	35%
ChemFree Customer C	10%	13%

7. *Commitments and Contingencies* Please refer to Note 7 to our Consolidated Financial Statements included in our 2009 Form 10-K for a description of our commitments and contingencies in addition to those disclosed here.

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. The trial took place during the week of July 13, 2009. At the conclusion of the trial, the judge issued several rulings from the bench which supported two of ChemFree s claims. However, other substantive matters have not yet been ruled upon. On May 5, 2010, the judge convened a hearing with both plaintiff and defendant attorneys and indicated that he expected to issue his final ruling in the matter in the near future. 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 remaining issues will be resolved in its favor. Depending upon the final rulings, ChemFree will have a number of options to consider which could include but are not limited to pursuit of recovery of damages or an appeal.

As previously disclosed, in our Form 10-K for the year ended December 31, 2009, management of IBS Technics, the company that acquired certain assets and the operations of our VISaer subsidiary in April 2008 alleged a breach of representations in the Asset Purchase Agreement (APA). On April 15, 2010, we received a formal notice from IBS Technics seeking indemnification under the APA in the amount of approximately \$2.6 million for alleged breaches of certain representations and warranties in the APA. We disagree with their allegations and intend to respond within 30 days of the notice date. If we cannot agree on a mutually acceptable resolution to this matter, it is possible that it will proceed to binding arbitration as required under the APA. Given the status of the matter and our belief that we have reasonable grounds to refute the IBS allegations and prevail in any litigation, presently we have not taken a reserve against the amount receivable from IBS Technics. If the matter is taken to arbitration or other legal proceedings, it is at least reasonably possible that the amount of the receivable could be reduced.

NYSE Amex Listing In December 2008, the NYSE Amex determined that we did not meet certain of the NYSE Amex continued listing standards, specifically relating to minimum shareholders equity of \$4 million. On March 16, 2009, the NYSE Amex accepted our plan to regain compliance with the continued listing standards by June 18, 2010. On April 14, 2010, we received notice from the NYSE Amex that we had regained compliance with the continued listing standards. As with all listed companies, we will be subject to regular monitoring to ensure compliance with continued listing standards. Failure to meet continued listing standards could impact our stock price.

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8. *Industry Segments* Segment information is presented consistently with the basis described in the 2009 Form 10-K. The following table contains segment information for the three months ended March 31, 2010 and 2009.

	Three Months Ended March 31,	
(unaudited, in thousands)	**2010**	**2009**
Information Technology		
Revenue	$ 562	$ 343
Operating loss	(277)	(579)
Industrial Products		
Revenue	3,135	2,445
Operating income	670	255
Consolidated Segments		
Revenue	3,697	2,788
Operating income (loss)	393	(324)
Corporate expenses	(307)	(371)
Consolidated operating income (loss)	$ 86	$ (695)
Depreciation and Amortization		
Information Technology	$ 23	$ 1
Industrial Products	102	119
Consolidated segments	125	120
Corporate	4	4
Consolidated depreciation and amortization	$ 129	$ 124
Capital Expenditures		
Information Technology	$ 99	$ (22)
Industrial Products	31	3
Consolidated segments	130	(19)
Corporate		2
Consolidated capital expenditures	$ 130	$ (17)

(unaudited, in thousands)	**March 31, 2010**	**December 31, 2009**
Identifiable Assets		
Information Technology	$ 2,748	$ 2,693
Industrial Products	4,460	3,824
Consolidated segments	7,208	6,517
Corporate	2,691	3,517

Consolidated assets	$	9,899	$	10,034

9. *Income Taxes* 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) in the quarter ended March 31, 2010. As of March 31, 2010, 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, 2010 and 2009.

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. Our VISaer subsidiary filed a separate U.S. federal income tax return prior to April 1, 2008. 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 2005.

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10. *Recent Accounting Pronouncements* *In* October 2009, the Financial Accounting Standards Board (FASB) issued accounting guidance which amends the criteria for allocating a contract s consideration to individual services or products in multiple-deliverable arrangements. The guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence if available, (2) third-party evidence if vendor-specific evidence is not available, and (3) estimated selling price if neither vendor-specific nor third-party evidence is available. This guidance is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 (January 1, 2011 for us), and we are currently evaluating the potential impact, if any, on our Consolidated Financial Statements.

In June 2009, the FASB issued accounting guidance which amends the consolidation principles for Variable Interest Entities (VIEs) by requiring consolidation of VIEs based on which party has control of the entity. The guidance is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. The adoption of this accounting guidance did not have a material impact on our Consolidated Financial Statements.

In May 2009, the FASB issued guidance establishing general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. This guidance was effective for interim or annual financial periods ending after June 15, 2009, and the adoption of this guidance did not have any impact on our Consolidated Financial Statements.

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.

11. *Subsequent Event* We evaluated subsequent events through May 14, 2010 when these financial statements were issued. Except as otherwise disclosed in this report, we are not aware of any 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 6. Management s Discussion and Analysis of Financial Condition and Results of Operations, in the Form 10-K for the year ended December 31, 2009 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).

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 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 be offset by an opposing change at another subsidiary.
- 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.
- 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 an unpredictable impact on consolidated revenue that is recognized in a given quarterly or annual period.

We reported a profit of $84,000 for the first quarter of 2010. However, frequently we report consolidated operating losses on a quarterly or annual basis and are likely to do so in the future from time to time. 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 initial software contracts are complete 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 subsidiary, affiliate and other minority-owned companies. 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 an affiliate company accounted for by the equity method. The timing and amount of any gain or loss recognized as a result of a sale or the amount of equity in the income or losses of affiliates generally are not under our control and are not necessarily indicative of future results, either on a quarterly or annual basis.

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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, 2010 was $3.7 million, a 33 percent increase compared to the first quarter of 2009. Revenue from sales in domestic and international markets represented approximately 86 percent and 14 percent, respectively, of total revenue.

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 $3.3 million in the three month period ended March 31, 2010, a 35 percent increase compared to $2.5 million in the three months ended March 31, 2009. The increase in product revenue in the first quarter of 2010 compared to the prior year reflects principally strong performance by our ChemFree subsidiary with higher volume of SmartWasher® parts washers sold in both the domestic and international markets reflecting the general economic recovery, as well as more sales of consumable supplies of fluid and filters to a larger base of SmartWasher® users. Software license revenue associated with the Information Technology segment increased in the three month period ended March 31, 2010 compared to the three month period ended March 31, 2009 reflecting a successful installation of CoreCard s first international customer.

Service revenue associated with the Information Technology segment was $350,000 in the first quarter of 2010, 16 percent higher than the level reported for the same period in 2009. The change is attributed mainly to an increase in the installed base of CoreCard customers that pay for maintenance and technical support.

Cost of Revenue Total cost of revenue was 51 percent of total revenue in the three month period ended March 31, 2010 compared to 58 percent of total revenue in the first quarter of 2009. The improvement is related principally to favorable changes in ChemFree s product mix from period to period as well as increased service revenue and lower costs to deliver services at CoreCard.

Cost of product revenue was 51 percent and 53 percent of product revenue in the three months ended March 31, 2010 and 2009, respectively. Higher margin consumable supplies (fluid and filters) represented a larger percentage of product revenue in the first quarter of 2010 than in the comparable period in 2009, resulting in an improved gross margin.

Cost of service revenue (which relates to our software business only) as a percent of service revenue was 50 percent and 97 percent in the three month periods ended March 31, 2010 and 2009, respectively. 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. The cost to provide annual maintenance and support services as a percentage of service revenue has declined as CoreCard s installed base of customers with maintenance contracts increases, since costs are spread across a larger maintenance revenue base. The cost of professional services revenue is tied to specific projects and generally yields higher gross margins compared to maintenance services, depending on the mix of our U.S. and offshore employees working on the project.

Operating Expenses In the three month period ended March 31, 2010, total consolidated operating expenses were 8 percent lower than in the corresponding period in 2009. Marketing expenses were higher by $122,000 (27 percent) in the three month period in 2010 compared to the same period in 2009 due to higher sales commissions paid by ChemFree, restoration of salary reductions that were in effect in 2009, and greater travel expenses to support sales growth. General and administrative expenses were 21 percent lower in the first quarter of 2010 than in the first quarter of 2009, reflecting mainly lower legal expenses. Research and development expenses were 13 percent lower in the first quarter of 2010 compared to the same period last year, mainly due to a greater allocation of personnel related R & D expenses to work-in-process for software contracts not yet complete.

Interest Income, net We recorded net interest income of $27,000 and $15,000 in the three months ended March 31, 2010 and 2009, respectively. The difference between periods reflects primarily the effect of higher interest earning bank deposits in the first quarter of 2010.

Equity in Income (Loss) of Affiliate Company On a quarterly basis, we recognize our pro rata share of the earnings or losses of an affiliate company that we account for by the equity method. We recorded $12,000 in net equity losses in the first quarter of 2010 compared to $7,000 in net equity income of our affiliate company in the three months ended March 31, 2009. The change between periods reflects a decline in profitability of the affiliate company due to expenses for new marketing and sales initiatives in 2010.

Income Taxes We recorded $23,000 and $1,000 in the three month periods ended March 31, 2010 and 2009, respectively, for state income tax expense at the ChemFree subsidiary. We believe our net deferred tax assets should be fully reserved at March 31, 2010 given their character and our historical losses. Accordingly, no deferred tax assets have been recorded at March 31, 2010.

Net Income (Loss) We earned net income of $84,000 in the first quarter of 2010 compared to a net loss of $662,000 in the first quarter of 2009. The improvement reflects a significant increase in profits earned by our ChemFree subsidiary and improved performance at our CoreCard subsidiary.

Liquidity and Capital Resources

Our cash balance at March 31, 2010 was $2.5 million compared to a cash balance of $2.8 million at December 31, 2009. During the three months ended March 31, 2010, we used $199,000 cash for operations, principally to support CoreCard and our international R&D operations. Working capital changes included an increase in accounts receivable of $243,000 due to higher sales and a decline of $186,000 in inventory levels due to lower purchasing volume and higher sales. We used cash for capital equipment expenditures for our expanding work force in India, a mold for certain parts washer parts and a disaster recovery site for CoreCard s new processing initiative.

We currently project that we will have sufficient liquidity from cash on hand and projected customer payments and periodic working capital borrowings, if needed, to support our operations in the foreseeable future. We have a bank line of credit with a maximum availability of $1.25 million based on qualifying accounts receivable and inventory levels which we use from time to time to support short-term cash needs. As of March 31, 2010, we have no borrowings under the line and we presently project that we will have sufficient accounts receivable, inventory balances and tangible net worth for the foreseeable future to support the borrowing base and loan covenants for any draws, if any, under our bank line of credit. However, the line expires on June 30, 2010, 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.

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 as 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, are 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, 2009. 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 2009. During the three month period ended March 31, 2010, 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 2009.

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.

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

- Continued weakness 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.
- Continued weakness in the domestic U.S. and certain European economies could impact the automotive parts and repair industry and reduce demand for ChemFree s SmartWasher® products and cause the company to have slower growth than anticipated.
- 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.
- As an alternative to licensing its software, CoreCard is now offering outsourced processing services running on the CoreCard software system. There are numerous risks associated with entering any new line of business and if CoreCard fails to manage the risks associated with its processing operations, it could have a negative impact on our business.
- One of ChemFree s customers represented approximately 35 percent of our consolidated revenue in the first quarter of 2010 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 our ChemFree subsidiary 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.
- Delays in production or shortages of certain sole-sourced parts for our ChemFree products could impact revenue and orders.
- 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).
- Increasing government regulation in the United States and foreign countries related to such issues as data privacy, financial and credit transactions could require changes to our products and services and could affect our existing customer relationships or prevent us from getting new customers.
- CoreCard could fail to expand its base of customers as quickly as anticipated, resulting in lower revenue and profits (or increased losses) and increased cash needs.
- In certain situations, ChemFree s 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.

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

Our future capital needs are uncertain and depend on a number of factors; additional capital may not be available on acceptable terms, if at all.

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

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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.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as described in Note 7 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, 2010, 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 March 18, 2010. (Incorporated by reference to Exhibit 3.(1) to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2009.)
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 14, 2010	By: */s/ J. Leland Strange*
	J. Leland Strange Chief Executive Officer, President
Date: May 14, 2010	By: */s/ Bonnie L. Herron*
	Bonnie L. Herron Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Descriptions
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