INTELLIGENT SYSTEMS CORP
Form 10-Q
May 15, 2012

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, 2012

OR

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

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 R No £

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

Large accelerated filer	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 £ No R

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, 2012, 8,958,028 shares of Common Stock of the issuer were outstanding.

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

Part I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2012 (unaudited)	December 31, 2011 (audited)
ASSETS		
Current assets:		
Cash	$3,077	$3,152
Marketable securities	228	209
Accounts receivable, net	2,745	2,504
Notes and interest receivable, current portion	243	249
Inventories, net	885	824
Other current assets	285	284
Total current assets	7,463	7,222
Investments	1,283	1,288
Notes and interest receivable, net of current portion	--	240
Property and equipment, at cost less accumulated depreciation	1,167	1,222
Patents, net	121	133
Total assets	$10,034	$10,105
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$754	$463
Deferred revenue, current portion	915	907
Accrued payroll	411	460
Accrued expenses	638	669
Other current liabilities	280	369
Total current liabilities	2,998	2,868
Deferred revenue, net of current portion	45	50
Other long-term liabilities	134	140
Commitments and contingencies (Note 8)		
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, 2012 and December 31, 2011	90	90
Additional paid-in capital	21,479	21,461
Accumulated other comprehensive loss	(63)	(111)
Accumulated deficit	(16,165)	(15,909)
Total Intelligent Systems Corporation stockholders' equity	5,341	5,531
Non-controlling interest	1,516	1,516
Total stockholders' equity	6,857	7,047
Total liabilities and stockholders' equity	$10,034	$10,105

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

Intelligent Systems Corporation

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended March 31, 2012	2011
Revenue		
Products	$3,418	$3,032
Services	676	512
Total revenue	4,094	3,544
Cost of revenue		
Products	1,686	1,548
Services	537	278
Total cost of revenue	2,223	1,826
Expenses		
Marketing	586	520
General & administrative	871	918
Research & development	668	639
Operating loss	(254)	(359)
Other income (expense)		
Interest income, net	4	11
Equity in income (loss) of affiliate company	(4)	9
Other income	10	6
Loss before income taxes	(244)	(333)
Income taxes	12	21
Net loss	$(256)	$(354)
Loss per share:		
Basic	$(0.03)	$(0.04)
Diluted	$(0.03)	$(0.04)
Basic weighted average common shares outstanding	8,958,028	8,958,028
Diluted weighted average common shares outstanding	8,958,028	8,958,028

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

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

	Three Months Ended March 31,	
CASH PROVIDED BY (USED FOR):	2012	2011
OPERATIONS:		
Net loss	$(256)	$(354)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	138	61
Stock-based compensation expense	19	8
Non-cash interest income, net	(4)	(3)
Equity in (income) loss of affiliate company	4	(9)
Changes in operating assets and liabilities		
Accounts receivable	(241)	(98)
Inventories	(61)	(80)
Other current assets	(1)	(239)
Accounts payable	291	177
Deferred revenue	8	156
Accrued payroll	(49)	(29)
Accrued expenses	(31)	16
Other current liabilities	(89)	(31)
Other long-term liabilities	(11)	(23)
Net cash used for operating activities	(283)	(448)
INVESTING ACTIVITIES:		
Proceeds from notes and interest receivable	250	600
Purchases of property and equipment	(71)	(191)
Net cash provided by investing activities	179	409
Effects of exchange rate changes on cash	29	(2)
Net decrease in cash	(75)	(41)
Cash at beginning of period	3,152	2,942
Cash at end of period	$3,077	$2,901
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for income taxes	$13	$19

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

Intelligent Systems Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Throughout this report, the terms “we”, “us”, “ours”, “ISC” and “company” refer to Intelligent Systems Corporation, includi its wholly-owned and majority-owned subsidiaries. The unaudited Consolidated Financial Statements presented in this Form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States applicable to interim financial statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of ISC management, these Consolidated Financial Statements contain all adjustments (which comprise only normal and recurring accruals) necessary to present fairly the financial position and results of operations as of and for the three month periods ended March 31, 2012 and 2011. The interim results for the three months ended March 31, 2012 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, 2011, as filed in our Annual Report on Form 10-K.

2. Option Agreement – As disclosed in Note 17 to our 2011 Annual Report Form 10-K, on March 20, 2012, Intelligent Systems Corporation entered into an Option Agreement (the “Option Agreement”) with Central National Bank, a national banking association (“CNB”). The Option Agreement grants to CNB the option to acquire from ISC the number of shares of stock in the company’s CoreCard Software subsidiary equal to five percent (5%) of ISC’s equity ownership in CoreCard. Currently, ISC owns approximately 96 percent of the equity of CoreCard. The number of shares covered by the option may be increased, up to ten percent (10%), based on achievement of certain volumes of prepaid cards issued by CNB and processed by CoreCard, as defined in the Option Agreement. The option has an exercise price of one million dollars, expires on December 31, 2017 and can be exercised at any time before it expires. Further, at any time between September 30, 2014 and June 30, 2017, subject to certain earlier termination provisions, CNB may elect to require ISC to repurchase the option at a purchase price equal to the fair market value of the option less one million dollars. We entered into the Option Agreement in recognition of CNB’s ongoing cooperation and contribution to building CoreCard’s card processing business. During the quarter ended March 31, 2012, we recorded an expense of $18,000 in the marketing category and recorded a long-term liability of $18,000 to recognize the financial impact of the Option Agreement.

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 Loss	Three Months Ended March 31,					
(unaudited, in thousands)	2012			2011		
Net loss	$	(256	)	$	(354	)
Other comprehensive income (loss)						
Unrealized gain on available-for-sale marketable securities		19			--	
Foreign currency translation adjustment		29			(2	)
Comprehensive loss	$	(208	)	$	(356	)

4. Stock-based Compensation – At March 31, 2012, 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 three month periods ended March 31, 2012 and 2011 has been recognized as a component of general and administrative expenses in the accompanying Consolidated Financial Statements. We recorded $19,000 and $8,000 of stock-based compensation expense in the quarters ended

March 31, 2012 and 2011, respectively.

The estimated fair value of options granted is calculated using the Black-Scholes option pricing model with assumptions as previously disclosed in our 2011 Form 10-K.

As of March 31, 2012, there is $150,000 of unrecognized compensation cost related to stock options. No options were granted during the three months ended March 31, 2012. The following table summarizes options as of March 31, 2012:

	# of Shares	Wgt Avg Exercise Price	Wgt Avg Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at March 31, 2012	342,500	$ 1.78	5.8	$ 12,240
Vested and exercisable at March 31, 2012	172,000	$ 1.95	2.5	$ 10,680

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 2012 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, 2012. The amount of aggregate intrinsic value will change based on the fair market value of the company's stock.

5. Fair Value of Financial Instruments - The carrying value of cash, marketable securities, 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 the non-interest bearing note receivable beyond one year approximates its fair value and has been discounted at a rate of 4% which approximates rates offered in the market for notes receivable with similar terms and conditions.

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash, marketable securities, trade accounts and note 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. Fair Value Measurements - In determining fair value, the Company uses quoted market prices in active markets. GAAP establishes a fair value measurement framework, provides a single definition of fair value, and requires expanded disclosure summarizing fair value measurements. GAAP emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability.

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

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

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

• Level 2
Valuations based on quoted prices in less active, dealer or broker markets. Fair values are primarily obtained from third party pricing services for identical or comparable assets or liabilities.

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

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

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

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

7. 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)	2012		2011	
ChemFree Customer A	13	%	11	%
ChemFree Customer B	29	%	33	%
ChemFree Customer C	10	%	11	%
ChemFree Customer D	--		11	%

8. Commitments and Contingencies – Please refer to Note 8 to our Consolidated Financial Statements included in our 2011 Form 10-K for a description of our commitments and contingencies in addition to those disclosed here.

Legal Matters – ChemFree Patent Matter – As reported in our 2011 Form 10-K, on March 12, 2012, the United States Court of Appeals issued its final ruling in the long-standing case brought by ChemFree on a patent infringement matter, affirming the invalidity findings of the lower court with respect to certain claims in four of ChemFree's patents. As a result of the ruling, ChemFree incurred a liability for certain allowable taxable costs. Accordingly, the company accrued for the estimated amount of such costs and recorded an expense of $75,000 reflected in the category Other Income and a corresponding liability reflected in Other Current Liabilities in its 2011 Consolidated Financial Statements. The total final amount of the liability for taxable costs was $76,000, which ChemFree paid in April 2012.

On September 29, 2011, ChemFree filed a second patent infringement action against J. Walter in the United States District Court for the Northern District of Georgia, alleging that certain of J. Walter's products infringe a newly issued patent held by ChemFree. The complaint seeks a ruling to compel the defendant to cease its infringing activities. The matter is in a preliminary phase.

In the ordinary course of business, from time to time we may be involved in various pending or threatened legal actions. The litigation process is inherently uncertain and it is possible that the resolution of such matters might have a material adverse effect upon our financial condition and/or results of operations. Except as noted above, other commitments and contingencies described in Note 8 to the Consolidated Financial Statements included in our 2011 Form 10-K are unchanged.

9. Industry Segments – Segment information is presented consistently with the basis described in the 2011 Form 10-K. The following table contains segment information for the three months ended March 31, 2012 and 2011.

	Three Months Ended March 31,	
(unaudited, in thousands)	2012	2011
Information Technology		

Revenue	$706	$550
Operating loss	(640)	(554)
Industrial Products		
Revenue	3,388	2,994
Operating income	833	582

(unaudited, in thousands)	Three Months Ended March 31, 2012	2011
Consolidated Segments		
Revenue	$4,094	$3,544
Operating income	193	29
Corporate expenses	(447)	(388)
Consolidated operating loss	$(254)	$(359)
Depreciation and Amortization		
Information Technology	$52	$40
Industrial Products	82	18
Consolidated segments	134	58
Corporate	4	3
Consolidated depreciation and amortization	$138	$61
Capital Expenditures		
Information Technology	$61	$127
Industrial Products	10	63
Consolidated segments	71	190
Corporate	--	1
Consolidated capital expenditures	$71	$191

(unaudited, in thousands)	March 31, 2012	December 31, 2011
Identifiable Assets		
Information Technology	$1,700	$1,791
Industrial Products	6,682	6,654
Consolidated segments	8,382	8,445
Corporate	1,652	1,660
Consolidated assets	$10,034	$10,105

10. 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 past two years. As of March 31, 2012 and December 31, 2011, the company has recorded a liability of $116,000, in connection with unrecognized tax benefits related to uncertain tax positions. The liability includes $20,000 of interest and penalties. As of March 31, 2012, management expects some incremental, but not significant, changes in the balance of unrecognized tax benefits over 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. During the three months ended March 31, 2012 and 2011, no interest or penalties were recognized.

We file a consolidated U.S. federal income tax return for all subsidiaries in which our ownership equals or exceeds 80%, as well as individual subsidiary returns in various states and foreign jurisdictions. With few exceptions we are no longer subject to U.S. federal, state and local or foreign income tax examinations by taxing authorities for years before 2008.

11.

Recent Accounting Pronouncements –We have considered all 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 – We evaluated subsequent events through the date when these financial statements were issued. 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 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission.

Overview

We derive our product revenue from sales and leases of equipment and supplies in our Industrial Products sector and from sales of software licenses in our Information Technology Products and Services sector. Our service revenue consists of fees for consulting, customization, training, processing services, maintenance and support for software products in our Information Technology Products and Services 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 impact consolidated revenue or be offset by an opposing change at another subsidiary.
- Software license revenue in a given period may consist of a relatively small number of contracts and contract values can vary considerably depending on the software product and scope of the license sold. Consequently, even minor delays in delivery under a software contract (which may be out of our control) could have a significant and unpredictable impact on the consolidated revenue that we recognize in a given quarterly or annual period.
- Customers may decide to postpone or cancel a planned implementation of our software for any number of reasons, which may be unrelated to our software or contract performance, but which may affect the amount, timing and characterization of our deferred and/or recognized revenue.

We have frequently recognized consolidated operating losses on a quarterly and annual basis and are likely to do so in the future from time to time. Our ChemFree subsidiary generates an operating profit and positive cash flow on a quarterly and annual basis. Our CoreCard subsidiary is not consistently profitable, mainly due to significant research and development expense that is invested in its product offerings and the deferral of initial contract revenue recognition until licensed software and associated services are delivered to its customers. Depending upon the size and number of software licenses recognized in a particular period and the level of expenses incurred to support existing customers and development and sales activities, CoreCard may report operating profits on an irregular basis as it builds a larger customer base. A significant portion of CoreCard's expense is related to personnel, including a workforce of approximately 200 employees located in India. In addition, CoreCard is now offering processing services as an alternative for customers who prefer to outsource this function instead of licensing our software and running the application in-house. There are a number of uncertainties related to a new line of business. We are likely to incur losses in the near future for the processing business because contract revenue is spread out over multi-year contracts while we are currently investing in the infrastructure, resources and processes to support this new processing business. For these and other reasons, our operating results may vary from quarter to quarter and at the present time are generally not predictable with a reasonable degree of certainty on a quarterly basis.

From time to time, we derive income from sales of holdings in affiliate and other minority-owned companies or we may 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 affiliate companies accounted for by the equity method. The timing and amount of the 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.

In recent years, most of our cash has been generated by our ChemFree operations and, on an irregular basis, from sales of our investments or subsidiaries, and from a shareholder rights offering in mid-2009. We have used a significant amount of the cash received from these transactions and operations to support the domestic and international operations associated with our CoreCard subsidiary and the corporate office.

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, 2012 was $4.1 million, an increase of 16 percent compared to the first quarter of 2011.

- 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 $3.4 million in the three month period ended March 31, 2012, compared to $3.0 million in the three months ended March 31, 2011. The 13 percent increase in product revenue in the first quarter of 2012 compared to the prior year was fueled by growth at the ChemFree subsidiary in the number of SmartWasher parts washers sold in the domestic U.S. market, as well as an increase in total consumable supplies and lease revenue.

- Service revenue associated with the Information Technology segment was $675,000 in the first quarter of 2012, a 32 percent increase compared to $512,000 in the first quarter of 2011. The change is attributed mainly to an increase in the installed base of CoreCard customers that pay for maintenance and technical support as well as more professional services projects that were completed for customers in 2012. We expect that maintenance and professional services revenue will continue to grow as CoreCard's customer base increases; however, it is not possible to predict with any accuracy the number and value of professional services contracts that CoreCard's customers will require in a given period. Customers typically require our professional services to modify or enhance their CoreCard software implementation based on their specific business strategy and operational requirements, which vary from customer to customer and period to period.

Cost of Revenue – Total cost of revenue was 54 percent of total revenue in the three month period ended March 31, 2012 compared to 52 percent of total revenue in the first quarter of 2011. Changes in product and customer mix between periods affects the overall costs as a percentage of revenue. Cost of product revenue as a percent of product revenue was 49 percent and 51 percent in the period ended March 31, 2012 and 2011, respectively, due to a higher ratio of domestic versus international sales in 2012. Cost of services was 79 percent of services revenue in 2012 compared to 54 percent in 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 and the mix of U.S. and offshore employees working on professional service projects impact the cost and gross margins during a given period. In addition, in 2012 our initial costs to develop and support the processing business are high.

Operating Expenses – In the three month period ended March 31, 2012, total consolidated operating expenses were two percent higher than in the corresponding period in 2011. Marketing expenses were higher by $66,000 (13 percent) in the three month period in 2012 compared to the same period in 2011, the majority of which are due to higher sale commissions incurred by ChemFree reflecting higher domestic equipment sales. General and administrative expenses were $48,000 (5 percent) lower in the first quarter of 2012 than in the first quarter of 2011, reflecting mainly lower legal expenses. Research and development expenses were $29,000 (5 percent) higher in the first quarter of 2012 compared to the same period last year, mainly due to an increase in the number of personnel at our India office.

Interest Income, net – We recorded net interest income of $4,000 and $11,000 in the three months ended March 31, 2012 and 2011, respectively. The difference between periods reflects primarily the fact that our total note receivable related to the sale of our former VISaer subsidiary was lower in 2012 than in 2011 due to a $600,000 payment received by the company in early 2011.

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 $4,000 in net equity loss in the first quarter of 2012 compared to $9,000 in net equity income in the first quarter of 2011. The change between periods reflects changes in results of operations of the affiliate company.

Income Taxes – We recorded $12,000 and $21,000 in the three month periods ended March 31, 2012 and 2011, respectively, for state income tax expense at the ChemFree subsidiary.

Net Loss – Overall, we recorded a net loss from continuing operations of $256,000 in the first quarter of 2012 compared to net loss of $354,000 in the first quarter of 2011.

Liquidity and Capital Resources

Our cash balance at March 31, 2012 was $3.1 million, essentially the same as at December 31, 2011. During the three months ended March 31, 2012, a principal source of cash was receipt of a scheduled $250,000 payment from the purchaser of our former VISaer subsidiary (as explained in more detail in Note 2 to the Consolidated Financial Statements contained in our 2011 Annual Report on Form 10-K). Major working capital changes included:

- an increase in accounts receivable of $241,000 reflecting mainly higher sales in March 2012 as compared to December 2011.
- an increase of $61,000 in inventory due mainly to building finished goods inventory to support ChemFree's sales growth and estimated near-term demand
- an increase in accounts payable of $291,000 reflecting the timing of receipt of inventory parts at quarter end as well as a reduction of $75,000 related to an obligation that had been accrued for and classified in the category Other Current Liability at December 31, 2011.

We used $71,000 cash to purchase computer and facility equipment at our operating companies.

We currently project that we will have sufficient liquidity from cash on hand, continued cash positive operations at ChemFree, projected customer payments at CoreCard and periodic working capital borrowings or sale of marketable securities, if needed, to support our operations and capital equipment purchases in the foreseeable future. We renewed our line of credit in June 2011 with a maximum principal availability of $1.25 million based on qualified receivables and inventory levels which we will use as necessary to support short-term cash needs. We have not drawn down under the bank line of credit in more than two years. 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 required draws under our bank line of credit. The line of credit expires June 30, 2012, subject to the bank renewing the line for an additional period. If the bank does not renew our line of credit and if we have unforeseen cash requirements, we may experience a short-term cash shortfall. Delays in meeting project milestones or software delivery commitments at CoreCard could cause customers to postpone payments and increase our need for cash. Presently, we do not believe there is a material risk that we will not perform successfully on any contracts but if customer payments are delayed for any reason, if we do not control costs or if we encounter unforeseen technical or quality problems, then we could require more cash than presently planned.

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 to accommodate short-term needs. Other long-term sources of liquidity include potential sales of investments, subsidiaries or other assets although there are no current plans to do so. Furthermore, 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 intangibles, valuation of investments and accrued expenses 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, 2011. 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 2011. During the three month period ended March 31, 2012, 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 2011.

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-control 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:

- Further weakness in the global financial markets could have a negative impact on CoreCard due to potential customers (most of whom perform some type of financial services) delaying purchase or software implementation decisions.
- Stricter regulations and 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.
- 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 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 29 percent of our consolidated revenue in the first quarter of 2012 and any unplanned changes in the volume of orders or timeliness of payments from such customer could potentially have a negative impact on inventory levels and cash, at least in the near-term.
- Delays in production or shortages of certain sole-sourced parts for our ChemFree products could impact revenue and orders.
- Anticipated increases in prices of raw materials and sub-assemblies could reduce ChemFree's gross profit if it is not able to offset such increased costs with higher selling prices for its products or other reductions in production costs. In 2011, the company raised prices on certain of its SmartWasher® products to offset cost increases but may not be able to do so in the future due to competitive pressure.
- 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.
- 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 and changing government regulations 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 which could increase our costs 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.
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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.
- 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.

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

As reported in our 2011 Form 10-K, on March 12, 2012, the United States Court of Appeals issued its final ruling in the long-standing case brought by ChemFree on a patent infringement matter, affirming the invalidity findings of the lower court with respect to certain claims in four of ChemFree's patents. As a result of the ruling, ChemFree incurred a liability for certain allowable taxable costs. Accordingly, the company accrued for the estimated amount of such costs and recorded an expense of $75,000 reflected in the category Other Income and a corresponding liability reflected in Other Current Liabilities in its 2011 Consolidated Financial Statements. The total final amount for the taxable costs liability was $76,000 which ChemFree paid in April 2012.

On September 29, 2011, ChemFree filed a second patent infringement action against J. Walter in the United States District Court for the Northern District of Georgia, alleging that certain of J. Walter's products infringe a newly issued patent held by ChemFree. The complaint seeks a ruling to compel the defendant to cease its infringing activities. The matter is in a preliminary phase.

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

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 May 4, 2011 (Incorporated by reference to Exhibit 3.(1) to the Registrant's Form 10-Q for the period ended March 31, 2011)

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.

101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definitions
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation

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

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, 2012

By: /s/ J. Leland Strange
J. Leland Strange
Chief Executive Officer, President

Date: May 15, 2012

By: /s/ Bonnie L. Herron
Bonnie L. Herron

Chief Financial Officer

EXHIBIT INDEX

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