

INTELLIGENT SYSTEMS CORP
Form 10-Q
May 15, 2015

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from _____ to _____

Commission file number 1-9330

INTELLIGENT SYSTEMS CORPORATION

(Exact name of registrant as specified in its charter)

Georgia

(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 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 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

Non-accelerated filer

Accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

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

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

As of April 30, 2015, 8,958,028 shares of Common Stock of the issuer were outstanding.

Intelligent Systems Corporation

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| Ex. 2.1 | Stock Purchase Agreement between CRC Industries, Inc. and Intelligent Systems Corporation dated March 31, 2015 (Incorporated by reference to Exhibit 2.1 to the Registrant’s Form 8-K dated March 31, 2015). | |
| Ex. 10.1 | Thirteenth Modification to Loan Documents by and among Intelligent Systems Corporation and Fidelity Bank dated March 31, 2015, filed herewith. | |
| Ex. 10.2 | Lease Agreement by and between Intelligent Systems Corporation and ISC Properties, LLC dated April 1, 2015, filed herewith. | |
| Ex. 31.1 | Section 302 Certification of Chief Executive Officer | |
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| Ex. 32.1 | Section 906 Certification of Chief Executive Officer and Chief Financial Officer | |
| Ex.101.INS** | XBRL Instance | |
| Ex.101.SCH** | XBRL Taxonomy Extension Schema | |
| Ex.101.CAL** | XBRL Taxonomy Extension Calculation | |
| Ex 101.DEF** | XBRL Taxonomy Extension Definitions | |
| Ex.101.LAB** | XBRL Taxonomy Extension Labels | |

Ex.101.PRE** XBRL Taxonomy Extension Presentation

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

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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)*

| As of | March 31, | December |
|--|------------------|-----------------|
| | 2015 | 31, 2014 |
| | (unaudited) | (audited) |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 20,750 | \$ 2,624 |
| Marketable securities | 465 | 463 |
| Accounts receivable, net | 448 | 501 |
| Other current assets | 210 | 338 |
| Restricted cash, current portion | 900 | -- |
| Assets from discontinued operations | -- | 3,012 |
| Total current assets | 22,773 | 6,938 |
| Investments | 1,629 | 1,605 |
| Property and equipment, at cost less accumulated depreciation | 555 | 581 |
| Restricted cash, noncurrent portion | 2,200 | -- |
| Other long-term assets | 78 | 81 |
| Total assets | \$ 27,235 | \$ 9,205 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 126 | \$ 90 |
| Deferred revenue, current portion | 607 | 610 |
| Accrued payroll | 519 | 582 |
| Accrued expenses | 31 | 24 |
| Other current liabilities | 274 | 274 |
| Liabilities from discontinued operations | 800 | 838 |
| Total current liabilities | 2,357 | 2,418 |
| Deferred revenue, net of current portion | 225 | 191 |
| Other long-term liabilities | -- | 18 |
| 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, 2015 and December 31, 2014 | 90 | 90 |
| Additional paid-in capital | 21,541 | 21,537 |
| Accumulated other comprehensive loss | (113) | (110) |

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| | | |
|--|-----------|-----------|
| Retained earnings (deficit) | 5,546 | (12,750) |
| Total Intelligent Systems Corporation stockholders' equity | 27,064 | 8,767 |
| Noncontrolling interest | (2,411) | (2,189) |
| Total stockholders' equity | 24,653 | 6,578 |
| Total liabilities and stockholders' equity | \$ 27,235 | \$ 9,205 |

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

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

| | Three Months Ended March 31, | |
|--|---|----------------------------|
| | 2015 | 2014 (restated) |
| Revenue | | |
| Products | \$136 | \$113 |
| Services | 933 | 993 |
| Total net revenue | 1,069 | 1,106 |
| Cost of revenue | | |
| Products | 59 | 58 |
| Services | 547 | 437 |
| Total cost of revenue | 606 | 495 |
| Expenses | | |
| Marketing | 71 | 79 |
| General and administrative | 367 | 332 |
| Research and development | 694 | 787 |
| Loss from operations | (669) | (587) |
| Other income | 2 | 6 |
| Loss from continuing operations before income taxes | (667) | (581) |
| Income taxes | 3 | -- |
| Loss from continuing operations | (670) | (581) |
| Gain on sale of discontinued operations, net of taxes | 18,746 | -- |
| Loss from discontinued operations, net of taxes | (3) | (181) |
| Net income (loss) | 18,073 | (762) |
| Net loss attributable to noncontrolling interest | 223 | 176 |
| Net income (loss) attributable to Intelligent Systems Corporation | \$18,296 | \$(586) |
| Earnings (loss) per share attributable to Intelligent Systems Corporation: | | |
| Basic | | |
| Continuing operations | \$(0.05) | \$(0.05) |
| Discontinued operations | 2.09 | (0.02) |
| Earnings (loss) per share | \$2.04 | \$(0.07) |
| Diluted | | |
| Continuing operations | \$(0.05) | \$(0.05) |
| Discontinued operations | 2.08 | (0.02) |
| Earnings (loss) per share | \$2.03 | \$(0.07) |
| Basic weighted average common shares outstanding | 8,958,028 | 8,958,028 |
| Diluted weighted average common shares outstanding | 9,029,273 | 8,953,028 |
| Net income (loss) attributable to Intelligent Systems Corporation: | | |
| Loss from continuing operations | \$(447) | \$(405) |
| Income (loss) from discontinued operations | 18,743 | (181) |

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Net income (loss) attributable to Intelligent Systems Corporation \$18,296 \$(586)

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

**Intelligent Systems
Corporation**

**CONSOLIDATED
STATEMENTS OF
COMPREHENSIVE
INCOME (LOSS)**

*(unaudited, in
thousands)*

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2015 | 2014 |
| Net income (loss) | \$18,073 | \$(762) |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustments | (4) | (5) |
| Unrealized gain on available-for-sale marketable securities | 2 | 16 |
| Total comprehensive income (loss) | 18,071 | (751) |
| Comprehensive loss attributable to noncontrolling interest | 222 | 176 |
| Comprehensive income (loss) attributable to Intelligent Systems Corporation | \$18,293 | \$(575) |

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): | 2015 | 2014 |
| OPERATING ACTIVITIES: | | |
| Net income (loss) | \$18,073 | \$(762) |
| Loss (income) from discontinued operations | (18,743) | 181 |
| Net loss from continuing operations | (670) | (581) |
| Adjustments to reconcile net loss from continuing operations to net cash used for operating activities: | | |
| Depreciation and amortization | 36 | 32 |
| Stock-based compensation expense | 4 | 21 |
| Equity in (income) loss of affiliate company | 6 | (5) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 53 | 31 |
| Other current assets | 128 | 27 |
| Other long term assets | 3 | 11 |
| Accounts payable | 36 | 42 |
| Accrued payroll | (63) | (27) |
| Deferred revenue, current portion | (3) | (131) |
| Accrued expenses | 7 | 104 |
| Other current liabilities | -- | (87) |
| Deferred revenue, net of current portion | 34 | (25) |
| Other long-term liabilities | (18) | -- |
| Net cash used for operating activities | (447) | (588) |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (10) | (63) |
| Long-term investment | (30) | -- |
| Net cash used for investing activities | (40) | (63) |
| Net cash provided by operating activities from discontinued operations | 415 | 169 |
| Net cash provided by (used for) investing activities from discontinued operations | 18,202 | (23) |
| Net cash provided by discontinued operations | 18,617 | 146 |
| Effects of exchange rate changes on cash | (4) | (5) |
| Net increase (decrease) in cash | 18,126 | (510) |
| Cash at beginning of period | 2,624 | 3,433 |
| Cash at end of period | \$20,750 | \$2,923 |

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

| | | |
|--|------|------|
| Cash paid during the period for income taxes | \$-- | \$13 |
|--|------|------|

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

Intelligent Systems Corporation**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

Throughout this report, the terms “we”, “us”, “ours”, “ISC” and “company” refer to Intelligent Systems Corporation, including 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, 2015 and 2014. The interim results for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the full year. These statements should be read in conjunction with our Consolidated Financial Statements and notes thereto for the fiscal year ended December 31, 2014, as filed in our Annual Report on Form 10-K/A.

Sale of Subsidiary; Discontinued Operations – On March 31, 2015, we and CRC Industries, Inc., a Pennsylvania corporation (“CRC”), entered into a Stock Purchase Agreement (the “Stock Purchase Agreement”) whereby we sold all of the issued and outstanding stock of our wholly owned subsidiary, ChemFree Corporation (“ChemFree”), to CRC (the “ChemFree Sale”). The purchase price for the all-cash sale was \$21,600,000, subject to customary post-closing adjustments, including a working capital adjustment. The company retained all net cash of ChemFree as of the closing date. In the quarter ended March 31, 2015, the company recorded a gain on the sale of ChemFree of \$18,746,000 and has retroactively classified the ChemFree operations as discontinued operations in all periods presented. The company intends to apply operating loss and capital loss carryforwards against the gain of sale and presently expects to incur an alternative minimum tax liability of approximately \$181,000 on the transaction, which amount is included in liabilities of discontinued operations as of March 31, 2015. At the closing, a total of \$3,300,000 of the purchase price was placed in escrow for purposes of securing our obligations to indemnify CRC and to refund a portion of the purchase price if ChemFree’s actual working capital amount on the closing date is less than the agreed upon target set forth in the Stock Purchase Agreement. Based on the initial post-closing working capital determination, we have accrued \$200,000 for a working capital adjustment, which amount is reflected in the gain on sale calculation at March 31, 2015. We anticipate that once the working capital adjustment becomes final and binding, an amount equal to \$1,100,000 less the final working capital adjustment will be released from escrow to the company in May 2015, assuming the absence of any outstanding claims for indemnification under the Stock Purchase Agreement. As of March 31, 2015, \$900,000 of the escrow funds is shown as Restricted Cash – Current Portion (reflecting the escrow of \$1,100,000 less the estimated \$200,000 working capital adjustment) and the remaining escrow balance of \$2,200,000, which will remain in escrow until September 30, 2016, is shown as Restricted Cash – Noncurrent Portion.

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

| | Three Months Ended March 31, | |
|---------------------------------------|---|-------------|
| <i>(unaudited, in thousands)</i> | 2015 | 2014 |
| Net sales | \$2,902 | \$2,564 |
| Operating loss | (3) | (179) |
| Net income (loss) before income taxes | 6 | (169) |
| Income taxes | 9 | 12 |
| Net loss from discontinued operations | \$(3) | \$(181) |

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

| <i>(in thousands, unaudited)</i> | March 31, 2015 | December 31, 2014 |
|---|-------------------------------|------------------------------|
| Major classes of assets included as part of discontinued operations: | | |
| Accounts receivable | \$ -- | \$ 1,276 |
| Inventories | -- | 1,042 |
| Property, plant & equipment | -- | 488 |
| Other assets | -- | 206 |
| Total assets of discontinued operations | \$ -- | \$ 3,012 |
| Major classes of liabilities included as part of discontinued operations: | | |
| Accounts payable | \$ 88 | \$ 190 |
| Accrued payroll | -- | 152 |
| Other current liabilities | 712 | 284 |
| Other liabilities | -- | 212 |
| Total liabilities of discontinued operations | \$ 800 | \$ 838 |

Stock-based Compensation – At March 31, 2015, 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 3. experience. Stock option compensation expense for the three month periods ended March 31, 2015 and 2014 has been recognized as a component of general and administrative expenses in the accompanying Consolidated Financial Statements. We recorded \$4,000 and \$21,000 of stock-based compensation expense in the quarters ended March 31, 2015 and 2014, respectively.

As of March 31, 2015, there is \$13,000 of unrecognized compensation cost related to stock options. No options were granted during the three months ended March 31, 2015. The following table summarizes options as of March 31, 2015:

| | # of Shares | Wgt Avg Exercise Price | Wgt Avg Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|--|------------------------|---|--|--|
| Outstanding at March 31, 2015 | 274,500 | \$ 1.72 | 5.8 | \$ 334,092 |
| Vested and exercisable at March 31, 2015 | 250,000 | \$ 1.76 | 5.4 | 296,437 |

The estimated fair value of options granted is calculated using the Black-Scholes option pricing model with assumptions as previously disclosed in our 2014 Form 10-K/A.

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 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2015. The amount of aggregate intrinsic value will change based on the market value of the company's stock.

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.

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

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.

6. *Inventories* – Following the sale of our former subsidiary, ChemFree, we no longer have any inventory.

Concentration of Revenue – In the three month periods ended March 31, 2015 and 2014, the two largest customers in each period represented an aggregate of 45 percent and 40 percent, of consolidated revenue from continuing operations. However, they were not the same two customers in both periods. Most of our customers have multi-year contracts with recurring minimum revenue as well as professional services fees that vary by period depending on their business needs.

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

Year ended December 31,

(in thousands)

| | |
|------------------------------|--------|
| 2015 (April 1 – December 31) | \$ 179 |
| 2016 | 198 |
| 2017 | 158 |
| 2018 | 34 |
| Total minimum lease payments | \$569 |

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.

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

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

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

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

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

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

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

- Subsequent Event* – On April 22, 2015, we commenced a modified “Dutch” auction style tender offer to purchase for cash shares of our common stock for an aggregate purchase price of no more than \$5 million. The tender offer expires May 19, 2015, unless extended. Depending upon the number of shares tendered and the purchase price per share, we could use up to \$5 million of our cash and reduce the number of shares outstanding by as much as 1.96 million shares (approximately 21.9%) during the quarter ended June 30, 2015. We have evaluated subsequent events through the date when these financial statements were issued and, except as disclosed above or elsewhere in this Form 10-Q, we are not aware of any other significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on our Consolidated Financial Statements.

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

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

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

Overview

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

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

We have frequently recognized consolidated operating losses on a quarterly and annual basis and are likely to do so in the foreseeable future. CoreCard may report operating profits on an irregular basis and its results vary in part depending on the size and number of software licenses recognized in a particular period and the level of expenses incurred to support existing customers and development and sales activities. A significant portion of CoreCard's expense is related to personnel, including approximately 200 employees located in India and Romania. In addition, CoreCard 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. In addition, we have certain corporate office expenses associated with being a public company that impact our operating results.

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

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

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

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

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

The recent sale of the ChemFree operations has resulted in significant cash balances. Presently we intend to use up to \$5 million to repurchase shares of our common stock pursuant to a modified “Dutch” auction tender initiated on April 22, 2015. We intend to use the additional proceeds to support the domestic and international operations associated with our CoreCard business and to expand our operations in the FinTech industry through financing the growth of CoreCard and, if appropriate opportunities become available, through acquisitions of businesses in this industry.

Results of Operations

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

Revenue – Total revenue from continuing operations in the three month period ended March 31, 2015 was \$1,069,000, three percent lower than total revenue in the first quarter of 2014.

Revenue from products, which includes software license fees (and, in some cases monthly support fees when the license and support fees are bundled) was \$136,000 in the three month period ended March 31, 2015, compared to \$113,000 in the three months ended March 31, 2014. The increase reflects growth in the number of accounts covered by certain software licenses.

Revenue from services was \$933,000 in the first quarter of 2015 compared to \$993,000 in the first quarter of 2014. Revenue from transaction processing services and professional services were both higher in the first quarter of 2015 as compared to the first quarter of 2014 due to an increase in the number of customers and accounts on file and more revenue was generated from professional services due to an increase in the number and value of professional services contracts completed during the first quarter of 2015. In the first quarter of 2015, total maintenance revenue from annual contracts for technical and software support was lower than in the first quarter of 2014 due to the expiration of a contract in the second quarter of 2014; however maintenance revenue associated with the current installed base of customers was higher than in the first quarter of 2014. We expect that processing services will continue to grow as CoreCard's customer base increases; however, the time required to implement new customer programs has proven longer than anticipated due to delays in third party integration and approval processes. It is not possible to predict with any accuracy the number and value of professional services contracts that CoreCard's customers will require in a given period. Customers typically request our professional services to modify or enhance their CoreCard software implementation based on their specific business strategy and operational requirements, which vary from customer to customer and period to period.

Cost of Revenue – Total cost of revenue was 57 percent and 45 percent of total revenue in the three month period ended March 31, 2015 and 2014, respectively.

Cost of product revenue as a percent of product revenue was 43 percent and 51 percent in the periods ended March 31, 2015 and 2014, respectively but essentially the same absolute dollar cost in both periods.

Cost of service revenue as a percentage of total service revenue was 59 percent in the first quarter of 2015 compared to 44 percent in the first quarter of 2014. Cost of service revenue includes three components: costs to provide annual maintenance and support services to our installed base of licensed customers, costs to provide professional services, and costs to provide our financial transaction processing services. The cost and gross margins on such services vary considerably depending on the customer mix, customer requirements and project complexity as well as the mix of our U.S. and offshore employees working on the various aspects of services provided. In addition, we continue to devote the resources necessary to support our developing processing business, including direct costs for regulatory compliance, infrastructure, network certifications, and customer support and currently expect these costs to continue to outpace processing revenue for the foreseeable future.

Operating Expenses – In the three month period ended March 31, 2015, total operating expenses from continuing operations were six percent lower than in the comparable period in 2014. Marketing expenses were lower by \$8,000 and General and Administrative expenses were higher by \$35,000, due to a number of changes between periods, none of which are individually material. Research and development expenses were \$93,000 (12 percent) lower in the first quarter of 2015 compared to the same period last year, mainly due to more technical personnel expenses being charged to direct cost of services for maintenance, professional services and processing.

Gain on Sale of Discontinued Operations – As explained in more detail in Note 2 to the Consolidated Financial Statements, we recorded a gain of \$18,746,000 on the sale of our ChemFree subsidiary in the first quarter of 2015.

Liquidity and Capital Resources

Our cash balance at March 31, 2015 was \$20.8 million compared to \$2.6 million at December 31, 2014. The principal source of cash during the period was the sale of the ChemFree subsidiary which generated cash proceeds of \$18.2 million on the closing of the transaction. In addition, a total of \$3.3 million of the sale price was placed in escrow for purposes of securing our obligations to indemnify the buyer and to refund a portion of the purchase price if ChemFree's actual working capital amount on the closing date is less than the agreed upon target working capital. As of March 31, 2015, \$1.1 million of the escrow funds (less an estimated working capital adjustment of \$200,000) is recorded as Restricted Cash - Current Portion and will be released in the second quarter of 2015. The remaining escrow balance of \$2.2 million will remain in escrow until September 30, 2016 and is recorded as Restricted Cash – Noncurrent Portion as of March 31, 2015.

During the three months ended March 31, 2014, continuing operations used \$447,000 cash for operations. In the current quarter, discontinued operations generated \$415,000 from operating activities, in addition to the proceeds from the sale of ChemFree discussed above.

As explained in Note 13 to the Consolidated Financial Statements, on April 22, 2015, we initiated a modified “Dutch” auction tender offer to purchase for cash shares of our common stock for an aggregate purchase price of up to \$5.0 million, which will be financed by a portion of the proceeds from the ChemFree sale. We expect to have sufficient liquidity from cash on hand as well as projected customer payments at CoreCard to support our operations and capital equipment purchases in the foreseeable future.

We renewed our line of credit in June 2014 with a maximum principal availability of \$1.25 million based on qualified receivables; however, we have not borrowed under the bank line of credit in the past five years and do not expect to do so in the foreseeable future. The line of credit expires June 30, 2016, subject to the bank renewing the line for an additional period.

We expect to use cash in excess of what is required for our current CoreCard operations for opportunities we believe will expand our CoreCard and FinTech business, although there can be no assurance that appropriate opportunities will arise.

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/A for the fiscal year ended December 31, 2014. 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/A for 2014. During the three month period ended March 31, 2015, 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/A for 2014.

Factors That May Affect Future Operations

Future operations 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 our CoreCard subsidiary could have a negative impact on our 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:

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. 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 negatively impact the processing services business and 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.

CoreCard's processing business is impacted, directly or indirectly, by more regulations than its licensed software business. If the company fails to provide services that comply with (or allow its customers to comply with) applicable regulations or processing standards, it could be subject to financial or other penalties that could negatively impact its business.

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.

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.

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 would increase our costs and could affect our existing customer relationships or prevent us from getting new customers.

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

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).

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 long-term 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 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 6. Exhibits

The following exhibits are filed or furnished with this report:

- 2.1 Purchase Agreement between CRC Industries, Inc. and Intelligent Systems Corporation dated March 31, 2015 (Incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K dated March 31, 2015)
- 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.)
- 10.1 Thirteenth Modification to Loan Documents by and among Intelligent Systems Corporation and Fidelity Bank dated March 31, 2015, filed herewith.
- 10.2 Lease Agreement by and between Intelligent Systems Corporation and ISC Properties, LLC dated April 1, 2015, filed herewith.
- 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, 2015 By: /s/ J. Leland Strange
J. Leland Strange
Chief Executive Officer, President

Date: May 15, 2015 By: /s/ Bonnie L. Herron
Bonnie L. Herron
Chief Financial Officer

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