

INTELLIGENT SYSTEMS CORP

Form 10-Q

August 14, 2008

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**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 June 30, 2008

OR

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

**For the transition period from _____ to _____
Commission file number 1-9330**

INTELLIGENT SYSTEMS CORPORATION

(Exact name of registrant as specified in its charter)

Georgia

58-1964787

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

4355 Shackleford Road, Norcross, Georgia

30093

(Address of principal executive offices)

(Zip Code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer 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 July 31, 2008, 4,478,971 shares of Common Stock of the Issuer were outstanding.

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

	June 30, 2008	December 31, 2007
	<i>(unaudited)</i>	
ASSETS		
Current assets:		
Cash	\$ 1,162	\$ 554
Accounts receivable, net	2,117	2,139
Notes and interest receivable, current portion	516	540
Inventories	1,310	1,424
Other current assets	630	2,217
Total current assets	5,735	6,874
Long-term investments	1,225	1,127
Notes and interest receivable, net of current portion	1,366	350
Property and equipment, at cost less accumulated depreciation	1,794	1,894
Goodwill, net	369	2,047
Other intangibles, net	291	313
Other assets, net		17
Total assets	\$ 10,780	\$ 12,622
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Line of credit	\$	\$ 593
Note payable, current portion	93	
Accounts payable	917	1,482
Deferred revenue	1,989	2,527
Accrued payroll	653	1,162
Accrued expenses and other current liabilities	1,300	1,235
Total current liabilities	4,952	6,999
Long-term liabilities	301	95
Commitments and contingencies (Note 8)		
Minority interest	1,516	1,516
Stockholders equity:		
Common stock, \$0.01 par value, 20,000,000 shares authorized, 4,478,971 shares issued and outstanding at June 30, 2008 and December 31, 2007	45	45
Additional paid-in capital	18,446	18,437
Accumulated other comprehensive loss	(193)	(127)
Accumulated deficit	(14,287)	(14,343)

Total stockholders' equity	4,011	4,012
Total liabilities and stockholders' equity	\$ 10,780	\$ 12,622

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenue				
Products	\$ 3,412	\$ 2,573	\$ 7,392	\$ 5,659
Services	307	460	403	649
 Total revenue	 3,719	 3,033	 7,795	 6,308
 Cost of revenue				
Products	1,894	1,496	4,009	2,566
Services	221	359	421	480
 Total cost of revenue	 2,115	 1,855	 4,430	 3,046
 Expenses				
Marketing	769	509	1,538	863
General & administrative	1,205	793	2,522	1,672
Research & development	904	731	1,713	1,612
 Loss from operations	 (1,274)	 (855)	 (2,408)	 (885)
 Other income (expense)				
Interest income (expense), net	(4)	45	(9)	111
Investment income		92		81
Equity in income of affiliate companies	27	41	53	42
Other expense		(4)		(6)
 Loss from continuing operations before income taxes	 (1,251)	 (681)	 (2,364)	 (657)
Income taxes	5		17	
 Loss from continuing operations	 (1,256)	 (681)	 (2,381)	 (657)
Loss from discontinued operations	(85)	(241)	(446)	(495)
Gain on sale of discontinued operations, no tax effect	2,884		2,884	97
 Net income (loss)	 \$ 1,543	 \$ (922)	 \$ 58	 \$ (1,055)
 Loss per share from continuing operations:				
Basic	\$ (0.28)	\$ (0.15)	\$ (0.53)	\$ (0.15)
Diluted	\$ (0.28)	\$ (0.15)	\$ (0.52)	\$ (0.15)
Income (loss) per share from discontinued operations:				
Basic	\$ 0.62	\$ (0.05)	\$ 0.54	\$ (0.09)

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Diluted	\$	0.62	\$	(0.05)	\$	0.54	\$	(0.09)
Income (loss) per share:								
Basic	\$	0.34	\$	(0.21)	\$	0.01	\$	(0.24)
Diluted	\$	0.34	\$	(0.21)	\$	0.01	\$	(0.24)
Basic weighted average common shares outstanding		4,478,971		4,478,971		4,478,971		4,478,971
Diluted weighted average common shares outstanding		4,546,365		4,478,971		4,545,727		4,478,971

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

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

CASH PROVIDED BY (USED FOR):	Six Months Ended June 30,	
	2008	2007
OPERATIONS:		
Net income (loss)	\$ 58	\$ (1,055)
Adjustments to reconcile net income (loss) to net cash used for operating activities:		
Depreciation and amortization	260	232
Stock-based compensation expense	9	4
Gain on sale of VISaer business	(2,884)	(97)
Non cash interest expense (income), net	(15)	
Investment income		(81)
Equity in income of affiliate companies	(53)	(42)
Changes in operating assets and liabilities		
Accounts receivable	22	(821)
Accrued interest receivable	5	
Inventories	112	(208)
Other current assets	892	602
Accounts payable	(93)	1
Accrued payroll	(251)	(44)
Deferred revenue	46	(1,042)
Accrued expenses and other current liabilities	6	18
Other liabilities	(42)	(29)
Cash used for operating activities	(1,928)	(2,562)
INVESTING ACTIVITIES:		
Proceeds from sale of discontinued operations	3,025	
Investment in subsidiary	(125)	
Sale of investment or marketable securities		131
Proceeds from notes and interest receivable	285	3,165
Payments on notes payable	(133)	(70)
Purchases of property and equipment	(154)	(668)
Cash provided by investing activities	2,898	2,558
FINANCING ACTIVITIES:		
Borrowings under line of credit	1,400	
Repayments made under line of credit	(1,820)	
Borrowings under other short-term arrangements	124	221
Cash provided by (used for) financing activities	(296)	221

Effects of exchange rate changes on cash	(66)	(15)
Net increase in cash	608	202
Cash at beginning of period	554	2,136
Cash at end of period	\$ 1,162	\$ 2,338

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the period for interest	\$ 42	\$
Cash paid during the period for income taxes	\$ 17	\$

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

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

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:***Sale of VISAer Business (Discontinued Operations):***

Below is a reconciliation of the cash and non-cash activities associated with the sale of the VISAer business, as disclosed in Note 3 to the consolidated financial statements.

	<i>(unaudited, in \$000s)</i>
Proceeds from sale:	
Cash	\$ 3,025
Note receivable, net of discount	1,261
Liabilities assumed by (assets transferred to) buyer:	
Other current assets	(695)
Property, plant and equipment, net	(15)
Intangible assets	(1,803)
Other assets	(17)
Accrued payroll	258
Accounts payable	472
Deferred revenue	584
Other liability	(126)
Accrued transaction related expenses	(60)
Gain on sale of VISAer business	\$ 2,884

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

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Intelligent Systems Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

- 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 and six month periods ended June 30, 2008 and 2007. The interim results for the three and six months ended June 30, 2008 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, 2007, as filed in our Annual Report on Form 10-KSB.
- Discontinued Operations* Effective April 16, 2008, the company and two subsidiaries, VISAer, Inc. and VISAer (U.K.) Limited (collectively, VISAer) completed the sale of substantially all the assets related to VISAer's business pursuant to the terms of an asset purchase agreement (the Asset Purchase Agreement) between IBS Technics, Inc. (IBS Technics) and the company and VISAer. IBS Technics is a subsidiary of IBS Software Services, Inc., a software services company that had previously provided certain software development services to VISAer as an independent third party contractor.

The purchase price consisted of \$3,025,000 paid in cash at closing plus future earn-out and contingent payments to be paid over four years based on certain performance metrics of the VISAer business following the sale, with guaranteed minimum payments aggregating \$1.5 million in cash (discounted to a net present value of \$1,278,000), payable in three equal installments in 2010, 2011 and 2012. In addition, IBS Technics assumed approximately \$258,000 in liabilities of VISAer related to employee vacation benefits and \$437,000 payable to IBS Technics for prior services. IBS hired the VISAer employees as of the effective date of the transaction. IBS Technics acquired assets, net of liabilities, of \$48,000 related to customer contracts and assumed the ongoing liabilities and obligations associated with such contracts. We retained the remainder of the liabilities of the VISAer business along with cash and accounts receivable aggregating approximately \$465,000 as of the closing date. Based on the carrying value of the assets and liabilities transferred to IBS Technics and the estimated costs and expenses incurred in connection with the sale, the company reported a gain on the sale transaction of \$2,884,000 in the quarter ended June 30, 2008.

The transaction also provides for contingent payments which may be earned based on the attainment by the acquired VISAer business of certain levels of revenue in each of the calendar years 2008 through 2011. As the amount, if any, of such payments is not quantifiable at this time, no amount has been recorded for such contingency payments.

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

	Three Months Ended June		Six Months Ended June	
	30,		30,	
<i>(unaudited, in thousands)</i>	2008	2007	2008	2007
Net sales	\$ 133	\$ 824	\$ 761	\$ 1,599
Operating loss	(95)	(237)	(454)	(479)

Net loss from discontinued operations	\$	(85)	\$	(241)	\$	(446)	\$	(495)
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4. *Comprehensive Income (Loss)* In accordance with Financial Accounting Standards Board Statement No. 130, Reporting Comprehensive Income, 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 <i>(unaudited, in thousands)</i>	Three Months Ended June		Six Months Ended June	
	30,	30,	30,	30,
	2008	2007	2008	2007
Net income (loss)	\$ 1,543	\$ (922)	\$ 58	\$ (1,055)
Other comprehensive income (loss)				
Foreign currency translation adjustment	(61)	5	(66)	(15)
Comprehensive income (loss)	\$ 1,482	\$ (917)	\$ (8)	\$ (1,070)

5. *Stock-based Compensation* At June 30, 2008, we have two stock-based compensation plans in effect. In December 2004, the FASB issued FASB Statement No. 123R, Share-Based Payment (SFAS No. 123R) which replaced APB No. 25 and SFAS No. 123. We adopted SFAS No.123R effective January 1, 2006 using the modified prospective application method of adoption which requires us to record compensation cost related to unvested stock awards by recognizing the unamortized grant date fair value in accordance with provisions of SFAS 123R on a straight line basis over the service periods of each award. We have estimated forfeiture rates based on our historical experience. Stock option compensation expense is recognized as a component of general and administrative expenses in the accompanying consolidated financial statements. As a result of adopting SFAS No. 123R, we recorded \$6,000 and \$4,000 of stock based compensation expense for the three months ended June 30, 2008 and 2007, respectively, and \$9,000 and \$4,000 of stock-based compensation expense for the six months ended June 30, 2008 and 2007, respectively.

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

As of June 30, 2008, there is \$24,000 of unrecognized compensation cost related to stock options. During the quarter ended June 30, 2008, an aggregate of 12,000 options were granted to the three independent members of the board of directors pursuant to the Non-employee Director Stock Option Plan (Director Plan). Pursuant to the terms of the Director Plan, the options were granted at fair market value on the date of the Annual Shareholders meeting. No options were exercised or forfeited during the three and six month periods ended June 30, 2008. The following table summarizes options as of June 30, 2008:

	# of Shares	Wgt Avg Exercise Price	Wgt Avg Remaining Life in Years	Aggregate Intrinsic Value
Outstanding at June 30, 2008	221,000	\$ 2.46	4.9	\$ 201,582
Vested and exercisable at June 30, 2008	203,000	\$ 2.37	4.5	\$ 201,582

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 second quarter of 2008 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 June 30, 2008. The amount of aggregate intrinsic value will change based on the fair market value of the company's stock.

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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.

<i>(unaudited)</i>	Three Months Ended June		Six Months Ended June	
	2008	2007	2008	2007
ChemFree Customer A	46%	27%	45%	15%
ChemFree Customer B	13%	16%	14%	14%
ChemFree Customer C	10%			
ChemFree Customer D			11%	
CoreCard Customer E				18%

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7. *Industry Segments* Segment information is presented consistently with the basis described in the 2007 Form 10-KSB. The table following contains segment information for continuing operations for the three and six month periods ended June 30, 2008 and 2007.

	Three Months Ended June		Six Months Ended June	
	30,		30,	
<i>(unaudited, in thousands)</i>	2008	2007	2008	2007
<i>Information Technology</i>				
Revenue	\$ 321	\$ 623	\$ 432	\$ 1,953
Operating loss	(945)	(605)	(2,022)	(411)
<i>Industrial Products</i>				
Revenue	3,398	2,410	7,363	4,355
Operating income (loss)	(146)	21	172	180
<i>Consolidated Segments</i>				
Revenue	3,719	3,033	7,795	6,308
Operating loss	(1,091)	(584)	(1,850)	(231)
Corporate expenses	(183)	(271)	(558)	(654)
Consolidated operating loss from continuing operations	\$ (1,274)	\$ (855)	\$ (2,408)	\$ (885)
<i>Depreciation and Amortization</i>				
Information Technology	\$ 26	\$ 22	\$ 60	\$ 74
Industrial Products	106			