INTELLIGENT SYSTEMS CORP
Form 10-Q
August 14, 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 June 30, 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	**58-1964787**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4355 Shackleford Road, Norcross, Georgia	**30093**

(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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	(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 July 31, 2015, 8,731,299 shares of Common Stock of the issuer were outstanding.

Intelligent Systems Corporation

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	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.

Part I Financial Information

Item 1. Financial Statements

Intelligent Systems Corporation

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

As of	**June 30, 2015**	**December 31, 2014**
	(unaudited)	(audited)
ASSETS		
Current assets:		
Cash	$ 18,448	$ 2,624
Marketable securities	445	463
Accounts receivable, net	542	501
Other current assets	233	338
Restricted cash, current portion	880	--
Assets from discontinued operations	--	3,012
Total current assets	20,548	6,938
Investments	1,665	1,605
Property and equipment, at cost less accumulated depreciation	712	581
Restricted cash, noncurrent portion	2,200	--
Other long-term assets	66	81
Total assets	$ 25,191	$ 9,205
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 70	$ 90
Deferred revenue, current portion	899	610
Accrued payroll	595	582
Accrued expenses	28	24
Other current liabilities	237	274
Liabilities from discontinued operations	181	838
Total current liabilities	2,010	2,418
Deferred revenue, net of current portion	187	191
Other long-term liabilities	--	18
Intelligent Systems Corporation stockholders' equity:		

Common stock, $0.01 par value, 20,000,000 shares authorized, 8,731,299 and 8,958,028 issued and outstanding at June 30, 2015 and December 31, 2014, respectively	87	90
Additional paid-in capital	20,864	21,537
Accumulated other comprehensive loss	(134)	(110)
Retained earnings (deficit)	4,754	(12,750)
Total Intelligent Systems Corporation stockholders' equity	25,571	8,767
Noncontrolling interest	(2,577)	(2,189)
Total stockholders' equity	22,994	6,578
Total liabilities and stockholders' equity	$ 25,191	$ 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 June 30, 2015	**2014**	**Six Months Ended June 30, 2015**	**2014**
Revenue				
Products	$139	$154	$275	$267
Services	1,069	815	2,002	1,808
Total net revenue	1,208	969	2,277	2,075
Cost of revenue				
Products	52	73	112	131
Services	626	453	1,170	890
Total cost of revenue	678	526	1,282	1,021
Expenses				
Marketing	52	75	123	155
General and administrative	725	202	1,093	533
Research and development	718	836	1,412	1,622
Loss from operations	(965)	(670)	(1,633)	(1,256)
Other income	27	127	29	133
Loss from continuing operations before income taxes	(938)	(543)	(1,604)	(1,123)
Income taxes	--	--	3	--
Loss from continuing operations	(938)	(543)	(1,607)	(1,123)
Gain (loss) on sale of discontinued operations, net of taxes	(20)	--	18,726	--
Income (loss) from discontinued operations, net of taxes	--	421	(3)	240
Net income (loss)	(958)	(122)	17,116	(883)
Net loss attributable to noncontrolling interest	165	254	388	431
Net income (loss) attributable to Intelligent Systems Corporation	$(793)	$132	$17,504	$(452)
Earnings (loss) per share attributable to Intelligent Systems Corporation:				
Basic				
Continuing operations	$(0.09)	$(0.03)	$(0.14)	$(0.08)
Discontinued operations	--	0.05	2.11	0.03
Earnings (loss) per share	$(0.09)	$0.02	$1.97	$(0.05)
Diluted				
Continuing operations	$(0.09)	$(0.03)	$(0.14)	$(0.08)
Discontinued operations	--	0.05	2.09	0.03
Earnings (loss) per share	$(0.09)	$0.02	$1.95	$(0.05)
Basic weighted average common shares outstanding	8,806,875	8,958,028	8,882,452	8,958,028
Diluted weighted average common shares outstanding	8,806,875	9,029,273	8,977,839	8,958,028
Net income (loss) attributable to Intelligent Systems Corporation:				
Loss from continuing operations	$(773)	$(289)	$(1,219)	$(692)
Income (loss) from discontinued operations	(20)	421	18,723	240

Net income (loss) attributable to Intelligent Systems Corporation	$(793)	$132	$17,504	$(452)

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 June 30,		Six Months Ended June 30,	
	2015	**2014**	**2015**	**2014**
Net income (loss)	$(958)	$(122)	$17,116	$(883)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(1)	2	(6)	(4)
Unrealized gain (loss) on available-for-sale marketable securities	(20)	23	(18)	39
Total comprehensive income (loss)	(979)	(97)	17,092	(848)
Comprehensive loss attributable to noncontrolling interest	165	254	388	431
Comprehensive income (loss) attributable to Intelligent Systems Corporation	$(814)	$157	$17,480	$(417)

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

Intelligent Systems Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

CASH PROVIDED BY (USED FOR):	**Six Months Ended June 30, 2015**	**2014**
OPERATING ACTIVITIES:		
Net income (loss)	$17,116	$(1,123)
Loss (income) from discontinued operations	(18,723)	240
Net loss from continuing operations	(1,607)	(883)
Adjustments to reconcile net loss from continuing operations to net cash used for operating activities:		
Depreciation and amortization	86	61
Stock-based compensation expense	8	33
Investment income, net	--	(125)
Equity in (income) loss of affiliate company	20	(2)
Changes in operating assets and liabilities:		
Accounts receivable	(41)	37
Other current assets	105	57
Other long term assets	15	21
Accounts payable	(20)	(29)
Accrued payroll	13	48
Deferred revenue, current portion	289	--
Accrued expenses	4	45
Other current liabilities	(37)	(29)
Deferred revenue, net of current portion	(4)	--
Other long-term liabilities	(18)	(51)
Net cash used for operating activities	(1,187)	(817)
INVESTING ACTIVITIES:		
Purchases of property and equipment	(217)	(93)
Long-term investment	(80)	169
Net cash used for investing activities	(297)	(76)
FINANCING ACTIVITIES:		
Sale of capital stock pursuant to exercise of option	8	--
Repurchase of capital stock pursuant to tender offer	(692)	--
Net cash used for financing activities	(684)	--
Net cash provided by (used for) operating activities from discontinued operations	(204)	287
Net cash provided by (used for) investing activities from discontinued operations	18,202	(37)
Net cash provided by discontinued operations	17,998	250
Effects of exchange rate changes on cash	(6)	(3)

Net increase (decrease) in cash	15,824	(494)
Cash at beginning of period	2,624	3,433
Cash at end of period	$18,448	$2,939

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)

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 and six month periods ended June 30, 2015 and 2014. The interim results for the three and six months ended June 30, 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.

2. *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 June 30, 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 accrued $200,000 for a working capital adjustment, which amount was reflected in the gain on sale calculation reported in the Form 10-Q for the period ended March 31, 2015. In the quarter ended June 30, 2015, we expensed an additional $20,000 for the final working capital adjustment. Accordingly, at June 30, 2015, $880,000 of the escrow funds is shown as Restricted Cash – Current Portion (reflecting the escrow of $1,100,000 less the final $220,000 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. In early July 2015, we received a cash disbursement of the Restricted Cash – Current Portion balance.

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

(unaudited, in thousands)	**Three Months Ended June 30, 2015**	**2014**	**Six Months Ended June 30, 2015**	**2014**
Net sales	--	$2,725	$2,902	$5,289
Operating income (loss)	--	416	(3)	237
Net income before income taxes	--	421	6	252
Income taxes	--	--	9	12
Net income (loss) from discontinued operations	--	$421	$(3)	$240

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

(in thousands, unaudited)	**June 30, 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	$--	$ 190
Accrued payroll	--	152
Other current liabilities	181	284
Other liabilities	--	212
Total liabilities of discontinued operations	$ 181	$ 838

3. *Tender Offer Stock Repurchase* - 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 expired May 19, 2015. We accepted for tender 230,729 shares of common stock at a purchase price per share of $3.00 for an aggregate purchase price of $692,187. Shares repurchased were cancelled, resulting in a decline in the number of outstanding shares at June 30, 2015.

4. *Stock-based Compensation* - At June 30, 2015, we had three stock–based compensation plans in effect. We record compensation cost related to unvested stock option awards by recognizing the unamortized grant date fair value 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. We recorded $4,000 and $12,000 of stock-based compensation expense in the three months ended June 30, 2015 and 2014, respectively and $8,000 and $33,000 for the six month periods ended June 30, 2015 and 2014, respectively. 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.

As of June 30, 2015, there is $34,000 of unrecognized compensation cost related to stock options. During the quarter ended June 30, 2015, an aggregate of 12,000 options were granted to three independent members of our board of directors pursuant to the 2011 Non-Employee Director Stock Option Plan (Director Plan). Pursuant to the terms of the Director Plan, the options were granted at fair value on the date of the Annual Shareholders meeting. During the six month period ended June 30, 2015, 4,000 options were exercised and 12,000 options expired unexercised.

The following table summarizes stock options as of June 30, 2015:

	# of Shares	Wgt Avg Exercise Price	Wgt Avg Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at June 30, 2015	274,500	$ 1.76	6.0	$ 345,975
Vested and exercisable at June 30, 2015	254,500	$ 1.72	5.8	$ 320,055

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 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 June 30, 2015. The amount of aggregate intrinsic value will change based on the fair value of the company's stock.

5. *Fair Value of Financial Instruments* - The carrying value of cash, accounts receivable, accounts payable and certain other financial instruments (such as short-term borrowings, accrued expenses, and other current liabilities) included in the accompanying consolidated balance sheets approximates their fair value principally due to the short-term maturity of these instruments.

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.

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. *Inventories* – Following the sale of our former ChemFree subsidiary on March 31, 2015, we no longer have any inventory.

8. *Concentration of Revenue* – In the three month periods ended June 30, 2015 and 2014, the two largest customers represented in aggregate 40 percent and 43 percent of consolidated revenue. In the six month period ended June 30, 2015 and 2014, the two largest customers represented in aggregate 39 percent and 37 percent of consolidated revenue. However, they were not the same two customers in all 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.

9. *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.

10. *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.

11. *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 June 30, 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.

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

13. *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.

14. *Subsequent Event* – We have evaluated subsequent events through the date when these financial statements were issued and 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/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 maintenance and support for licensed software products, fees for processing services that we provide to companies that outsource their financial transaction processing functions to CoreCard and professional services primarily for software customizations provided to both license and processing customers.

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 offers processing services as an alternative for customers who prefer to outsource this function instead of licensing our software and running the application in-house. 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. We used $692,000 to repurchase shares of our common stock pursuant to a modified "Dutch" auction tender that ended on May 19, 2015. We intend to use cash balances 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 and six month periods ended June 30, 2015 was $1,208,000 and $2,277,000, respectively, which represent increases of 25 percent and 10 percent compared to the respective periods in 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 $139,000 and $275,000 in the three and six month periods, respectively, ended June 30, 2015, compared to $154,000 and $267,000 in the same periods in 2014. Changes between periods generally reflect the timing of tier upgrade fees related to the number of accounts covered by certain software licenses.

Revenue from services was $1,069,000 and $2,002,000 in the three and six month periods ended June 30, 2015, which represent an increase of 31 percent and 11 percent compared to the respective periods in 2014. Revenue from transaction processing services and professional services were both higher in the second quarter and year-to-date periods of 2015 as compared to the same periods in 2014 due to an increase in the number of customers and accounts on file for processing operations and more revenue was generated from professional services due to an increase in the number and value of professional services contracts completed in 2015. Maintenance revenue from annual contracts for technical and software support was higher in the second quarter of 2015 than in the same period last year. However, year-to-date maintenance revenue was lower in 2015 than in the corresponding period in 2014, due to the expiration of a contract in the second 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 56 percent of total revenue in both the three and six month periods ended June 30, 2015 compared to 54 percent and 49 percent in the corresponding periods in 2014.

Cost of product revenue as a percent of product revenue was 37 percent and 41 percent in the three and six month periods ended June 30, 2015 which is an improvement from prior periods in 2014, due to fewer resources required to support our licensed customers.

Cost of service revenue as a percentage of total service revenue was 58 percent in both the second quarter and year-to-date periods in 2015 compared to 56 percent and 49 percent in the corresponding periods in 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 can vary considerably from period to period 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 and six month periods ended June 30, 2015, total operating expenses from continuing operations were higher than in the corresponding periods in 2014. General and administrative expenses were significantly higher (over $500,000) in the second quarter and year-to-date periods of 2015 than in the corresponding periods in 2014. In 2015, the major reason for the increase is bonuses paid in the second quarter of 2015 following the ChemFree sale as well as transaction expenses for the tender offer. In addition, in 2014 a significant component of corporate G&A expenses was charged to our former ChemFree subsidiary for services provided by the corporate office to ChemFree and is included in the line item Income/Loss from Discontinued Operation. Following the sale of ChemFree in March 2015, corporate activities and resources (and the associated expense) have been re-focused on our continuing operations, primarily the CoreCard business and strategic initiatives, resulting in higher G&A expenses for continuing operations in 2015. Research and development expenses were 14 percent lower in the second quarter of 2015 and 13 percent lower year-to-date 2015 compared to the corresponding periods 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 $18,726,000 on the sale of our ChemFree subsidiary in the year-to-date period of 2015.

Liquidity and Capital Resources

Our cash balance at June 30, 2015 was $18,448,000 compared to $2,624,000 at December 31, 2014. The principal source of cash during the period was the sale of the ChemFree subsidiary which generated cash proceeds of $18,202,000 on the closing of the transaction. In addition, a total of $3,300,000 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 June 30, 2015, $880,000 of the escrow funds are recorded as Restricted Cash – Current Portion, reflecting $1,100,000 of the escrow funds less the final estimated working capital adjustment of $220,000. This amount was released and paid to us in early July 2015. The remaining escrow balance of $2,200,000 will remain in escrow until September 30, 2016 and is recorded as Restricted Cash – Noncurrent Portion as of June 30, 2015.

During the six months ended June 30, 2015, continuing operations used $1,187,000 cash for operations of the CoreCard business and corporate office as well as payment of bonuses related to the sale of the ChemFree subsidiary. We also used $217,000 cash to acquire computer equipment for our processing data center and to upgrade office equipment for technical resources and $80,000 for long-term investments.

As explained in Note 3 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. Upon completion of the tender offer, we purchased and retired 230,729 shares, using $692,000 of the proceeds from the ChemFree sale.

In the six months ended June 30, 2015, discontinued operations generated $17,998,000 net cash, principally from the sale of ChemFree discussed above.

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 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 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.

Item 6. Exhibits

The following exhibits are filed or furnished with this report:

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 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).
Ex 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.)
Ex 10.1	Thirteenth Modification to Loan Documents by and among Intelligent Systems Corporation and Fidelity Bank dated March 31, 2015 (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q for the period ended March 31, 2015).
Ex 10.2	Lease Agreement by and between Intelligent Systems Corporation and ISC Properties, LLC dated April 1, 2015 (Incorporated by reference to Exhibit 10.2 to the Registrant's Form 10-Q for the period ended March 31, 2015).
Ex. 31.1	Section 302 Certification of Chief Executive Officer
Ex. 31.2	Section 302 Certification of Chief Financial Officer
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.

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: August 14, 2015	By: /s/ *J. Leland Strange* J. Leland Strange Chief Executive Officer, President
Date: August 14, 2015	By*:* /s/ *Bonnie L. Herron* Bonnie L. Herron Chief Financial Officer

Exhibit Index

Exhibit No.	**Descriptions**
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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 Document
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