INTELLIGENT SYSTEMS CORP
Form 10-K405
March 22, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

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) (I.R.S. Em

4355 SHACKLEFORD ROAD, NORCROSS, GEORGIA

(Address of principal executive offices)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGI
COMMON STOCK, $.01 PAR VALUE	AMERICAN STOCK EXCHANGE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: None

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

As of March 15, 2002, 4,495,530 shares of Common Stock were outstanding. The aggregate market value of the Common Stock held by non-affiliates of the registrant was $3,494,558 (computed using the closing price of the Common Stock on March 15, 2002 as reported by the American Stock Exchange).

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2002, are incorporated by reference in Part III hereof.

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PART I

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Form 10-K may contain forward-looking statements relating to Intelligent Systems Corporation (ISC). All statements, trend analysis and other information contained in the following discussion 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", "likely" 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, and that actual results may differ materially from those contemplated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are delays in product development, undetected software errors, competitive pressures, technical difficulties, market acceptance, availability of technical personnel, changes in customer requirements, changes in financial markets, performance and financial condition of affiliate companies, and general economic conditions. ISC undertakes no obligation to update or revise its forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results.

ITEM 1. BUSINESS

OVERVIEW

Intelligent Systems Corporation, a Georgia corporation, has operated either in corporate or partnership form since 1973 and its securities have been publicly traded since 1981. In this report, sometimes we use the terms "company", "we", "ours" and similar words to refer to Intelligent Systems Corporation. We operated as a master limited partnership from 1986 to 1991, when we merged into the present corporation. Our executive offices are located at 4355 Shackleford Road, Norcross, Georgia 30093 and our telephone number is (770) 381-2900.

Since the early 1980's, we have conducted our operations principally through majority owned subsidiaries or minority owned affiliates to which we devote extensive management resources. Frequent acquisitions of or investment in promising early stage companies in the technology industry have long been components of our overall strategy. Since most of our companies are early or growth stage businesses, from time to time they may require funding, in excess of what we can provide, from third parties or the public markets to support their business plan. They may seek to be acquired or to merge with another company in response to various market conditions or if circumstances indicate that operating as a stand-alone company is not in their best interest. As a result, our ownership position frequently changes from time to time. Moreover, in the past several years, we have sold or discontinued several subsidiaries, such as InterQuad Services and PsyCare America, generally in response to what we believe to be unfavorable industry trends or prospects as stand-alone companies. We anticipate that generally lower valuations for early stage companies and our increased liquidity will allow us to increase the number of companies we control and in which we are involved in day-to-day management of their operations.

Our main focus is to help entrepreneurs build valuable companies by providing operational and strategic management, practical business advice, early stage equity capital, a network of business contacts and, in some cases, a proven incubator program. Depending upon the needs of the partner company, we will undertake a variety of roles which often include day-to-day management of operations, board of director participation, financing, market planning, strategic contract negotiations, personnel and administrative functions, etc. Most of our partner companies are involved in the information technology industry (principally software for business applications) although we are involved in other industries as well (including industrial products, biotechnology, and wireless).

FINANCIAL REPORTING

We consolidate the results of operations of our partner companies in which we own a majority interest or exert control. We account for investments in affiliate companies in which we own 20 to 50 percent or in which we exert significant influence by the equity method. In general, under the equity method, we include our pro rata share of the income or loss generated by each of these businesses as investment income (loss) on a quarterly basis. These equity losses and income decrease or increase, respectively, our cost basis of the investment. However, if there is no commitment for ISC to provide additional funding to the company, to the extent losses exceed our cost, we do not record a value below zero. Because of this equity method accounting treatment, some of our affiliate companies may be recorded at zero on our balance sheet but their estimated market value may be substantially higher. Privately owned partner companies in which we own less than 20 percent of the equity are carried at the lower of cost or market. We do not mark up the value of privately-owned businesses even when they raise money at higher valuations. We are often actively engaged in managing strategic and operational issues with our non-consolidated companies and devote significant resources to the development of the business.

RECENT ACQUISITION AND INDUSTRY SEGMENT OVERVIEW

On July 1, 2001, we increased our ownership in VISaer, Inc. from a 40 percent interest to a 65 percent interest. The purchase was treated as a step acquisition and we have consolidated the results of operations of VISaer, Inc. since the date of the transaction. See Note 2 to the Consolidated Financial Statements for details of the transaction and related purchase accounting. Our consolidated companies operate in two industry segments: Information Technology products and services, and Industrial Products. The Information Technology segment includes our VISaer and QS Technologies subsidiaries and the Industrial Products segment includes ChemFree. Prior to 2001, we reported information on two segments: Technology and Health Care. In November 2000, we sold the principal operating assets of our PsyCare subsidiary in response to unfavorable market conditions in the managed health care environment. Therefore, we do not have a Health Care industry segment in 2001. We also changed our segment reporting to separate the ChemFree operations as our new Industrial Products segment and renamed the Technology segment as the Information Technology segment. We have restated segment data from prior reporting periods to correspond to the current industry segments. All of our subsidiaries are wholly-owned except for VISaer, in which our ownership is 65 percent.

Operations in the Information Technology segment are involved in the design, development and marketing of application software products that are used by business customers and government agencies to manage aspects of their operations. Our software products are typically sold in competitive bids with relatively long sales and implementation cycles. We receive software license fees that vary depending upon the number of licensed users and the number of software modules licensed with total contract revenue typically ranging from $100,000 to more than a million dollars. We also derive service revenue from implementation, customization, training and support services.

The Industrial Products segment includes the design, assembly and sale of equipment and associated supplies that are used by commercial, industrial, military and government agencies to maintain and service machinery or vehicles used in their operations. Our assembled products are shipped to resellers or direct to customer sites and do not require set-up or on-site support from us.

Unit pricing varies by model but typical end-user prices are less than $2,000. Customers purchase replacement supplies from us after the sale.

Our individual operations in both segments are relatively small in size and are subject to greater fluctuation in revenue and profitability than larger, more established businesses. The business in our segments is not seasonal. In each of the three years ended December 31, 2001, revenue related to ChemFree and QS Technologies products have represented more than 15 percent each of consolidated revenue. In 2001, revenue related to VISaer's products represented more than 15 percent of consolidated revenue. For ease of comprehension, the business discussion which follows contains information on products, markets, competitors, research and development and manufacturing for our operating subsidiaries, organized by industry segment and by company. For further detailed financial information concerning our segments, see Notes 15 and 18 in the accompanying Notes to the Consolidated Financial Statements.

INDUSTRY SEGMENT: INFORMATION TECHNOLOGY PRODUCTS AND SERVICES

VISAER - VISaer develops, sells and supports software for the world-wide commercial aviation industry. The VISaer software helps aviation customers manage the extensive requirements and processes involved in their maintenance, repair and overhaul (MRO) operations. Headquartered in Wilmington, Massachusetts, VISaer also has operations in England and Ireland to support product development and sales activities in Europe. VISaer is the successor company of Visibility, Inc., a software company in the enterprise resource planning market whose operations were sold in July 2000 to allow VISaer to concentrate on the faster growing MRO software market. VISaer's current product offering, VISaer 2.4, includes the following major components: technical records planning and management, MRO operations, materials management, production scheduling, commercial operations and financial management. Version 2.5, scheduled for release in the second half of 2002, will include additional modules and features. VISaer expects to release Version 3.0, a fully Web-native version of the complete MRO solution, in late 2002. In mid-2001, VISaer signed a major contract with United Parcel Systems (UPS) for its Version 3.0 software and has approximately $2.6 million in deferred revenue at December 31, 2001 associated with the contract. In addition, VISaer has a backlog of approximately $3-4 million related mainly to this contract and annual support contracts. Revenue related to the UPS contract will be recognized upon contract completion which is anticipated in early 2003. The UPS contract has certain non-competition and acceptance provisions that the company must comply with.

The general slow-down in the global economy and the terrorist attacks of September 11, 2001 have had a significant negative impact on the commercial aviation market. The company believes that some airlines have delayed or canceled planned information technology projects and others may not have the financial strength to weather the current downturn. However, regulatory requirements dictate that airlines manage their MRO processes carefully and there is increased pressure to improve and automate MRO record-keeping. VISaer's software products provide a comprehensive, cost-effective way to do so. VISaer expects that low-cost airlines, defense related aviation, MRO service outsourcing companies, private airlines and emerging global markets will provide additional sales opportunities beyond the larger commercial airlines.

VISaer markets and sells its software products and related support and maintenance services to customers in both domestic and foreign markets. In some

cases, it sells direct to the customer; in other cases, it sells through re-sellers such as Unisys Corporation that represents the company on a non-exclusive basis in several Pacific Rim markets. Sales through Unisys represented 18 percent of consolidated revenue in 2001. In most cases, sales are made in response to competitive bids and RFP's and have sales cycles of 6-18 months with implementation periods of 6-18 months. VISaer provides full suite implementation services and post-sales support and maintenance activities under annual contracts as well as ongoing professional services. VISaer has a number of competitors, some of whom offer MRO software as part of an Enterprise Resource Planning package and who have significantly more financial resources, larger customer bases and greater market coverage than VISaer. Other competitors are smaller players focused on MRO solutions with resources similar to VISaer. The company competes on the basis of providing full product functionality and integration, offering a complete software and service solution, and providing software that runs on industry standard technology platforms. VISaer expects that its Web-native software version will be a strong competitive offering.

QS TECHNOLOGIES - QS Technologies operates from its Greenville, South Carolina location, providing health and human services software products, maintenance and support services to its installed customer base as well as new customers. QS Technologies' products allow public health agencies to capture, analyze and manage client information such as immunization, maternal health, and birth and death records. The market includes local, state and federal public health agencies nationwide as well as other government agencies, hospitals and clinics. The market is fragmented and limited in size. QS Technologies competes against a number of other software companies, many of which are small vendors like itself and some of which are larger with access to greater resources. QS Technologies competes on the basis of product functionality and value, reputation for customer service and knowledge of market requirements acquired through twenty years in the market. Sales are typically made in response to competitive bids and may take six to twelve months to complete. Demand for products and the timing of contract awards is impacted by general economic conditions as well as customer-specific factors such as state and local budgets and program priorities, over which QS has little control. Typically, QS Technologies provides its customers with post-sales service and support under annual contracts that often renew for multiple years after the initial software license fee is earned. QS Technologies is engaged in new product

development (including a web-based initiative) and enhanced sales activities to expand its customer base and generate future revenue.

INDUSTRIAL PRODUCTS SEGMENT

CHEMFREE CORPORATION - Our only subsidiary in the Industrial Products segment is ChemFree Corporation (ChemFree), one of our early incubator companies, that designs, manufactures and markets a line of parts washers under the SmartWasher(TM) trademark. SmartWashers use an advanced bio-remediation system to clean automotive and machine parts without using hazardous, solvent-based chemicals. SmartWashers consist of a molded plastic tub and sink, recirculating pump, heater, control panel, filter with microorganisms, and aqueous based degreasing solutions. Unlike traditional solvent-based systems, there are no regulated, hazardous products used or produced in the process and the SmartWasher system is completely self-cleaning. ChemFree sells replacement fluid and filters to its customers on a regular basis after the initial parts washer sale.

ChemFree's markets include the automotive, transportation, industrial and military markets. The automotive market includes companies and governmental agencies with fleets of vehicles to maintain; automobile manufacturers with extensive service networks such as Chrysler, GM and BMW; and individual and chains of auto repair shops and auto parts suppliers. The industrial market includes customers with machinery that requires routine maintenance, such as in the textile industry. Military applications include vehicle service depots in all branches of the military. ChemFree sells its products directly to high volume customers as well as through several distribution channels, including international distributors in Europe and the Pacific Rim. ChemFree also sells in competitive bid situations and under a GSA schedule to government agencies. Because ChemFree sells in part through large national distributors such as NAPA in the United States and exclusive distributors in certain international markets, its results could be impacted negatively if one or more of such customers discontinues distribution and sales of ChemFree products. One of ChemFree's international distributors represented 10 percent of consolidated revenue in each of the last two years. Part of ChemFree's revenue is derived from multi-year contracts under which ChemFree provides SmartWashers and supplies to large corporate customers, such as Firestone, at multiple corporate sites.

ChemFree competes with larger, established companies that offer solvent-based systems, other small companies using non-hazardous systems, and hazardous waste hauling firms. Although smaller than the established solvent-based firms, ChemFree believes it is competitive based on product features, positive environmental impact, improved health and safety features, elimination of regulatory compliance, and price.

Warranty service, typically covering a one-year period, is provided either by ChemFree personnel or through its distributors and dealers. ChemFree subcontracts the manufacturing of major sub-assemblies built to its specifications to various vendors and performs final assembly and testing at its own facility. While there are multiple sources available for subassemblies, ChemFree frequently contracts with a single source for certain components in order to benefit from lower prices and consistent quality.

INCUBATOR PROGRAM

For more than ten years, we have operated the Intelligent Systems Incubator at our corporate facility in the suburbs of Atlanta, Georgia. We believe our incubator program is one of the longest running and largest self-funded incubator programs in the United States. In exchange for a monthly facility fee, incubator companies have access to resources such as office space, conference facilities, telecommunication and network infrastructure, business advice and planning, a network of professional services, and, in some cases, financial capital. Depending upon the experience and needs of the founding entrepreneur, incubator companies will choose to use some or all of the available resources. The incubator staff takes care of time-consuming infrastructure issues so the entrepreneur can focus on driving business development. Income from incubator companies reduces our total facility and personnel costs. The incubator also provides us with the opportunity for day-to-day involvement with emerging companies that may become partnership companies, either as majority-owned subsidiaries or minority-owned affiliates. In 1999, ChemFree Corporation, an incubator company and majority owned company, was named Incubator Company of the Year (Manufacturing category) by the National Business Incubation Association.

We are equity partners in some but not all of the companies in our incubator program. Because we have a large incubator facility, we can offer the benefits of the incubator program to non-affiliate companies. Conversely, many of our subsidiary and minority owned partner companies are not located in our incubator. In attracting companies to our incubator program, we compete with other sources of business assistance, facilities and financial capital that may be available to the entrepreneur. These sources include other incubator programs as well as angel and venture capital investors, corporate partner relationships and merger/sale opportunities. We do not record revenue from incubator lease income; rather such amounts are offset against the corporate facility expenses.

AFFILIATED PARTNER COMPANIES

Part of our business strategy is to seek out and form relationships with companies that we believe are involved in promising technologies or markets with good growth potential. From time to time, we have acquired or invested in such companies and expect to continue to do so as a regular part of our strategy. When we become involved, these companies are privately held, early stage companies in technology-related fields. We are often actively involved in helping the companies develop and implement their business plans. Some examples of our involvement are as follows:

- Initially, we owned a 40 percent equity position in VISaer, Inc., a privately held company that designs, develops and markets software products addressing the global aircraft maintenance, repair and overhaul market. We increased our ownership in VISaer to 65 percent in 2001 and now consolidate its results.

- Initially we own a 27 percent interest in Delos Payment Systems, Inc., a development stage software company spun off from former affiliate company, PaySys International, Inc. in April 2001. As of January 2002, due to a default by Delos on an outstanding loan, we acquired control of Delos, we are actively involved in managing the company at our incubator facility and we will consolidate its results of operations. Refer to Note 20 to the consolidated financial statements.

- A 25 percent interest in affiliate company CoreXpand, a software company with an e-commerce application for promotional and incentive product distributors. CoreXpand is part of the Intelligent Systems Incubator program.

- An 18 percent interest in Cirronet Inc., a privately held and former incubator company involved in wireless telecommunications products for industrial and commercial markets as well as residential and small business wireless Internet markets. Refer to Note 4 to the Consolidated Financial Statements.

- A less than one percent position in Atherogenics, a pharmaceutical company involved in novel drugs which address inflammatory diseases such as cardiovascular disease and asthma. Atherogenics completed its initial public offering in August 2000. We were part of the original investor group of Georgia-based institutions supporting the company's efforts to commercialize technology developed at Emory University.

- A three percent interest in RF Solutions, Inc., a start-up company that is developing proprietary radio frequency integrated chips used in broadband wireless products. The development stage company is building on the founding team's world-renowned research at Georgia Tech to develop commercial products.

RESEARCH AND DEVELOPMENT

The Company spent $3,371,000, $915,000 and $805,000 in the fiscal years ended December 31, 2001, 2000 and 1999, respectively, on company sponsored research and development. The Information Technology segment increased spending on software development significantly in 2001 mainly due to an intensive effort related to the VISaer 3.0 product line, which is expected to continue through at least 2002.

PATENTS, TRADEMARKS AND TRADE SECRETS

The ChemFree subsidiary has several patents (both issued and pending) covering certain aspects of its products and processes. It may be possible for competitors to duplicate certain aspects of these products and processes even though we regard such aspects as proprietary. We have registered with the US Patent and Trademark Office

and various foreign jurisdictions numerous trademarks and service marks for our products. We believe that an active trademark and copyright protection program is important in developing and maintaining brand recognition and protecting its intellectual property. Our companies presently market their products under trademarks and service marks such as SmartWasher, OzzyJuice, VISaer and others.

PERSONNEL

As of February 28, 2002, we had 145 full-time equivalent employees in our majority-owned or controlled companies. Our employees are not represented by a labor union, we have not had any work stoppages or strikes and we believe our employee relations are good.

ITEM 2. PROPERTIES

At February 28, 2002, we have leases covering approximately 137,500 square feet in Atlanta, GA, 6,100 square feet in Greenville, SC, and 21,400 square feet in Wilmington, MA, as well as small offices in Warrington, England and in Dublin, Ireland to house our product development, manufacturing, sales, service and administration operations. We believe our leased facilities are adequate for our existing and foreseeable business operations. A portion of the Atlanta corporate facility is subleased to businesses in our technology business incubator.

ITEM 3. LEGAL PROCEEDINGS

In 1999, a former consultant of the ChemFree subsidiary brought suit against ChemFree and other third parties challenging the ownership of certain of ChemFree's patents. ChemFree and other parties to the suit strongly deny the allegations, have filed a counterclaim and are vigorously defending the suit, which is pending in the Superior Court of Gwinnett County, Georgia. In 2001, we were named as a co-defendant in a lawsuit filed by four former employees of PaySys International, Inc. claiming certain rights to acquire shares of PaySys stock that we acquired from PaySys founders in 1994. We strongly deny that any valid claim exists and are vigorously defending the suit which is pending in the Ninth Judicial Circuit in Orange County, Florida. In addition, we are party to a small number of other legal matters arising in the ordinary course of business. It is management's opinion that none of these other matters will have

a material adverse impact on our consolidated financial position or results of operations. Refer to Note 10 to the consolidated financial statements.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We did not submit any matter to a vote of our shareholders during the fiscal quarter ended December 31, 2001.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is listed and traded on The American Stock Exchange ("AMEX") under the symbol "INS". The following table sets forth, for the periods indicated, the range of high and low sales prices for our common stock as reported by AMEX.

YEAR ENDED DECEMBER 31,	2001		2000	
	HIGH	LOW	HIGH	LOW
1ST QUARTER	4.00	3.02	14.50	3.625
2ND QUARTER	4.92	3.30	10.25	3.50
3RD QUARTER	4.60	3.10	6.25	3.75
4TH QUARTER	3.35	2.95	6.00	2.875

We had 438 shareholders of record as of February 28, 2002. This number does not include beneficial owners of our common stock whose shares are held in the names of various dealers, clearing agencies, banks, brokers and other fiduciaries. We paid a special cash dividend of $0.52 per common share on April 20, 2000. The company

may pay cash dividends from time to time on an irregular basis but has not in the past paid regular dividends and does not expect to do so in the future.

ITEM 6. SELECTED FINANCIAL DATA

(in thousands except share amounts)

TWELVE MONTHS ENDED DECEMBER 31,	2001	2000	1999	19
Net Sales	$ 8,718	$ 7,027	$ 8,479	$
Net Income (Loss)	9,113a	8,215b	249c	
Net Income (Loss) Per Share (Basic)	1.78	1.47	0.05	
Total Assets	26,089	18,057	13,658	
Working Capital	10,206	3,294	(48)	
Long-term Debt	--	--	363	
Stockholders' Equity	17,858	14,674	10,209	

Cash Dividends Paid Per Common Share	--	$ 0.52	--	
Shares Outstanding at Year End	4,495,530	5,623,784	5,114,467	5,1

a. Includes investment gains of $19.9 million, $2.2 million in net losses in equity of affiliates and non-recurring charges totaling $6.4 million related to acquisition.

b. Includes investment gains of $9.7 million and $771,000 in net losses in equity of affiliates.

c. Includes investment gains of $2.2 million and $948,000 in net losses in equity of affiliates.

d. Includes $944,000 charge for purchased in-process R&D, $955,000 charge to discontinue product lines, $5.2 million gain on investments and $593,000 income in equity of investments.

e. Includes $953,000 charge for purchased in-process R&D, $2.6 million gain on investments, $3.0 million write-off of note receivable and $2.3 million loss in equity of investments.

Please refer to Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operations for a discussion of material acquisitions or dispositions that may affect the comparability of this financial information.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In addition to historical information, this Form 10-K may contain forward-looking statements relating to Intelligent Systems Corporation (ISC). All statements, trend analysis and other information contained in the following discussion relative to markets for our products and trends in revenue, gross margins and anticipated expense levels, as well as other statements including works 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, and that actual results may differ materially from those contemplated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are delays in product development, undetected software errors, competitive pressures, technical difficulties, market acceptance, availability of technical personnel, changes in customer requirements, changes in financial markets, performance and financial condition of affiliate companies, and general economic conditions. 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.

RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and the notes to the consolidated financial statements presented in this annual report.

OVERVIEW - Our consolidated subsidiaries during 2001 operate in two industry segments: Information Technology and Industrial Products. Included in the Information Technology sector are QS Technologies, Inc. (software for health

and human services) and, since July 1, 2001, VISaer, Inc. (software for maintenance, repair and overhaul

operations in the aerospace industry). The Industrial Products segment includes ChemFree Corporation (bio-remediating parts washers). In prior years, we also had a Health Care segment consisting of our PsyCare America subsidiary prior to closing the operation in November 2000.

Net profit in 2001 was $9,113,000 compared to $8,215,000 in 2000. Included in the 2001 results is a pre-tax gain of $17,770,000 on the sale of our ownership in PaySys International, Inc. in April 2001. The results for 2000 reflect a gain of $8,622,000 from the sale of most of our ownership of Risk Laboratories, LLC. Both of these events are described more fully in Note 3 to the consolidated financial statements. Our net loss from operations in 2001 was $10,420,000 compared to a net loss of $976,000 in 2000. The current year operating results include non-recurring charges totaling $6.4 million in the third quarter of 2001 related to the acquisition of a controlling interest in VISaer in July 2001, as more fully explained in Note 2 to the consolidated financial statements. In addition, VISaer is incurring significant current expenses for software development while revenue for related software licenses is being deferred until the completed software product is delivered to customers in early 2003.

In the past several years, a significant portion of our income has been derived from sales of holdings in affiliate and other minority-owned companies. We also recognize on a regular basis our pro rata share of the income or losses of affiliate companies accounted for by the equity method. The timing and amount of gain or loss recognized as a result of a sale or the amount of equity in the income or losses of affiliates generally are not under our control and are not necessarily indicative of future results. Occasionally, as in the case of VISaer, we acquire a controlling interest in a company previously accounted for by the equity method and consolidate its results as of the acquisition date. Therefore, period-to-period comparisons of results of operations may not be meaningful or indicative of future results.

SALES - Total revenue in 2001 was $8,718,000, an increase of 24 percent compared to revenue of $7,027,000 in 2000. Revenue from products, which includes sales of equipment in our Industrial Products segment as well as software license fees related to the Information Technology segment, increased 10 percent year-to-year whereas revenue from services billed by the Information Technology segment increased 54 percent year-to-year. The growth in both revenue categories reflects mainly the benefit of the mid-year acquisition of VISaer. We did not record service revenue in the Health Care segment in 2001 since we closed the PsyCare operation in 2000.

Net sales in 2000 declined by 17 percent compared to 1999, principally due to lower service revenue in the Health Care segment, reflecting fewer hospital-based treatment programs and the close of the PsyCare operation in November 2000. Revenue in the Information Technology segment was down slightly year-to-year while sales in Industrial Products in both domestic and international markets grew slightly in 2000 compared to the prior year.

COST OF SALES - In 2001, total cost of sales was 47 percent of revenue, compared to 42 percent in 2000 and 47 percent in 1999. Cost of product sales as a percentage of product revenue was essentially the same in 2001 and 2000. Cost of service sales in the Information Technology segment increased in 2001

compared to 2000 mainly due to the inclusion of VISaer costs following the VISaer acquisition. VISaer professional services have a higher labor component and cost than do services provided by QS Technologies. The decline in 2000 compared to 1999 reflects reduced personnel costs in the Information Technology and Health Care segment as we scaled back the PsyCare operation and lower direct material costs in the Industrial Products segment. Cost of product sales is likely to decrease as a percentage of sales in future periods as a greater portion of anticipated product revenue is derived from software license fees.

OPERATING EXPENSES - In 2001, marketing expenses more than doubled compared to 2000, reflecting the inclusion of VISaer expenses for six months in 2001 as well as increased expenditures in the Industrial Products segment to support new sales and marketing initiatives. General and administrative expenses increased over 200 percent in 2001 compared to 2000, reflecting non-recurring charges totaling $6 million to write-down goodwill associated with the VISaer acquisition, the inclusion of VISaer expenses for six months and management bonuses related to the sale of PaySys. Research and development expense in 2001 increased by 268 percent compared to 2000 mainly due to significant new product development expense in the Information Technology segment as well as a non-recurring charge of $425,000 to record in-process research and development projects related to the acquisition of VISaer.

In 2000, marketing expenses were down eight percent compared to the prior year, mainly because the prior year amounts included expenses for an operation that was sold in 1999. Marketing expenses for Industrial Products increased during 2000 to generate and support higher revenue levels. General and administrative expenses were lower by almost $300,000 in 2000 compared to 1999. The reduction is related to reduced personnel and facility expenses as the Health Care segment wound down its operations, offset in part by higher legal costs to protect intellectual property assets in the Industrial Products segment. Corporate expenses, which are part of general and administrative expenses, were also higher in 2000 compared to 1999 mainly due to management bonuses. Research and development expenses in both Industrial Products and Information Technology sectors increased in 2000 as compared to 1999 to support development of new and enhanced product offerings.

INTEREST INCOME - In 2001, we recorded $1.0 million in interest income compared to interest income of $434,000 in 2000 and interest expense of $88,000 in 1999. The increase in 2001 compared to 2000 is mainly related to interest earned on a $3.5 million, high-interest note through April 2001 and significant cash balances since then, both related to our PaySys affiliate sale. In 2000 as compared to 1999, we earned interest on substantially higher levels of cash during the first half of 2000 and also earned interest on a higher level of notes at higher rates of interest in 2000.

INVESTMENT INCOME - Investment income related to sales of affiliate companies has been a major source of our profits in each of the last two years. In 2001, the main components of investment income of $19.9 million are $17.8 million from the sale of our interest in PaySys and a gain of $1.9 million on sales related to Risk Laboratories. For 2000, we recorded a gain of $8.6 million on the sale of part of our ownership in Risk Laboratories as well as investment gains totaling $1.0 million related to sales of shares of common stock of Primus and S1. In 1999, we recorded net investment income of $1.2 million on the sale of equity holdings in three private software companies and a gain of $995,000 on the sale of our holdings in MediaMetrix stock. Refer to Note 3 for details on the sale transactions described in this section.

EQUITY LOSSES OF AFFILIATES - On a quarterly basis, we recognize our pro rata share of the earnings or losses of affiliate companies that we record on the equity method. These companies are typically early stage companies that incur losses during their development and early revenue stages. We recorded $2.2 million of net equity losses in 2001, compared to $771,000 and $948,000 in net equity losses in 2000 and 1999, respectively. In 2001, the majority of the equity loss relates to Delos Payment Systems whereas the majority of the equity loss in 2000 and in 1999 relates to VISaer.

OTHER INCOME - Other income/expense in each of the last three years consists of miscellaneous, non-recurring sources of income and expense. Included in 2001 is $961,000 of deferred gain related to a VISaer product line sale in July 2000. In 1999, this category includes a non-recurring charge of $141,500 related to a former subsidiary bankruptcy case.

TAXES - In 2001, we incurred income tax expense of $173,000, representing a tax liability of $384,000 for alternative minimum tax on the PaySys transaction (tax loss carryforwards offset 90 percent of the gain) and a tax benefit of $211,000 recorded at the VISaer subsidiary. We incurred income tax expense totaling $203,000 in 2000 relating to operating income at the QS Technologies subsidiary and a small amount of investment income related to the Risk Laboratories sale that could not be sheltered by tax loss carryforwards. We had no income tax expense in 1999 because investment gains were offset by capital loss carryforwards.

COMMON SHARES - In 2001, we repurchased 1,132,000 shares of our common stock, including one million shares in the self-tender offer completed July 12, 2001. In 2000, executive officers exercised options to acquire a total of 635,986 shares of common stock and surrendered a total of 101,769 shares of common stock in partial payment of the exercise price. We also repurchased and retired 24,900 shares during 2000 pursuant to a stock repurchase plan announced in August 2000.

LIQUIDITY AND CAPITAL RESOURCES

For the year ended December 31, 2001, our principal sources of cash were $17.8 million from the sale of our interest in PaySys, $4.3 million from repayment of principal and interest related to a bridge loan to PaySys, $1.9 million from the sale of our Risk units, $842,000 on sales of other investments and $195,000 in interest from other

notes receivable and bank balances. During the year, our principal uses of cash were $5.8 million to acquire and retire 1,132,000 shares of our common stock, $1.5 million to retire our bank debt, $400,000 for bridge loans to investees, $2.8 million for follow-on investments in technology companies and $2.0 million for operations, principally to fund working capital needs at VISaer and the corporate office.

Long-term investments decreased $3.0 million at December 31, 2001 compared to the prior year-end. The main component of this amount is reclassification of $2.9 million of the carrying value of VISaer when it was acquired in July 2001 and we began consolidating its results. The balance of the decline is a combination of new investments in technology companies, equity losses of affiliate companies, sales of investments and changes in market prices of publicly held stocks. Increases year-to-year in the balances of accounts

receivable, accounts payable, other accrued liabilities, deferred revenue and deferred gain are principally the result of consolidating the assets and liabilities of VISaer since its acquisition. Inventories increased year-to-year to support a higher level of sales at ChemFree.

As of December 31, 2001, we have cash of $12.0 million. We believe our cash balances and available-for-sale securities will be adequate to support our operations and plans for the foreseeable future. As we have in the past, we expect to continue to identify opportunities for new and follow-on investments or acquisitions and would expect to use some available cash for these purposes. Since the terrorist attacks of September 11, 2001, our Information Technology segment has experienced delays in contract awards and implementations which, if they continue, may have a negative impact on results of operations and increase the segment's cash requirements, which we intend to fund or arrange funding for. However, we believe we have more than adequate cash reserves to meet any such needs. We do not have off-balance sheet arrangements, relationships, transactions or guarantees with third parties or related parties that would affect our liquidity or results of operations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We consider certain accounting policies related to revenue recognition, valuation of acquired intangibles and impairment of long-lived assets, and valuation of investments to be critical policies due to the estimation processes involved in each. For a detailed description on the application of these and other accounting policies, see Note 1 to the Consolidated Financial Statements beginning on page F-7.

Revenue Recognition. Our product revenue consists of fees from software licenses and sales of equipment and supplies. Our service revenue consists of fees for implementation, consulting, training, maintenance and support for software products. A portion of our revenue is derived from software contracts that contain significant production, modification and/or customization requirements and license fees for such contracts are recognized using contract accounting. We recognize revenue on a percentage of completion basis that involves estimating our progress on the contract based on input measures. We recognize revenue and the related costs in the same proportion that the amount of labor hours incurred to date bears to the total estimated hours required for contract completion. If reliable estimates cannot be determined or if there is an acceptance clause in the contract, all revenue is deferred until the customer has accepted the software and any refund rights have expired. If we do not accurately estimate the resources required or the scope of work to be performed, or we do not manage the contract properly, in future periods we may need to restate revenues or to incur additional cost which would impact our margins and reported results.

Valuation of Intangibles. Purchase accounting for an acquisition requires use of accounting estimates and judgments to allocate the purchase price to the fair market value of the assets and liabilities purchased. Our business acquisitions typically result in goodwill and other intangible assets. The determination of the value of such intangible assets requires management to make estimates and assumptions that affect the amount of future period amortization expenses and possible impairment expense that we will incur. Periodically we review the values assigned to long-lived assets using an estimate of the undiscounted cash flows of the entity over the remaining life of the asset. Any resulting impairment could require a write-down that would have a material adverse impact on our financial condition or results of

operations.

Valuation of Investments. We hold minority interests in non-publicly traded companies whose values are difficult to determine and are based on management's estimate of realizability of the carrying value of the investment. Future adverse changes in market conditions, poor operating results or lack of progress of the underlying investment could result in losses or an inability to recover the current carrying value of the investment. Our policy is to record an impairment charge when we believe an investment has experienced a decline in value that is other than temporary. Such charges could have a material adverse impact on our financial condition or results of operations. We also hold minority interests in several publicly-traded companies whose shares experience price volatility and are thinly traded. The carrying value of these investments reflects the market value of the shares at the balance sheet date. Future values could increase or decrease and we may not be able to realize the current carrying value due to changes in the market price of the stock or limited liquidity of the stock.

FACTORS THAT MAY AFFECT FUTURE OPERATIONS

Future operations in both the Information Technology and Industrial Products segments are subject to risks and uncertainties that may negatively impact our results or projected cash requirements. In addition, the value of our investments are impacted by a number of factors beyond our control. Among the factors that may affect our consolidated results of operations are delays in product development, undetected software errors, competitive pressures, technical difficulties, market acceptance of our products, availability of technical personnel, changes in customer requirements, delays in customer payments, changes in financial markets, performance and financial condition of affiliate or investee companies, and general economic conditions.

In 2001, we loaned $1.5 million to an affiliate company, Delos Payment Systems, Inc., a development stage software company, under a secured loan agreement. The affiliate loan was recorded as an equity investment and we subsequently recorded $1.42 million in equity losses related to Delos, reducing the carrying value of our investment to $80,000 at December 31, 2001. In early January 2002, Delos defaulted on repayment of the loan, we acquired control of the Delos board of directors and, consequently, we are consolidating the Delos operations and our 27 percent ownership of common stock of Delos in 2002. We are providing additional borrowings of $1.5 million to Delos under the loan and are considering investing funds to increase our ownership to a significant majority position. It will incur operating losses that we will consolidate and it will require cash to operate in 2002. While we have no contractual requirement to provide additional funding, we are likely to use part of our available cash balances to support the Delos operations in the near-term. If Delos is unsuccessful or if we decide to suspend funding, we may not recover all of these funds.

As a result of consolidating Delos, we will record intangible assets upon consolidation in the first quarter of 2002 in accordance with SFAS 141. It is possible that the intangibles will be mainly in-process research and development and goodwill and the goodwill may be impaired for a number of reasons. Some of the factors that may negatively impact the value of the goodwill are significant non-competition restrictions related to the sale of PaySys in April 2001 that limit who Delos can sell its products to for varying time periods through 2006, risks associated with completing and testing the

initial software application, lack of a proven business model and customers, a limited operating history, and unproven market acceptance of the Delos software features and architecture. If the company determines that the intangibles are impaired, it will need to write-down their value to net realizable value in the first quarter of 2002 in accordance with SFAS 142, resulting in a charge to earnings of approximately $1 million. Despite the possible impairment charge, we made the additional loan of $1.5 million to Delos to protect our investment and future alternatives.

We have certain lease commitments, legal matters and contingent liabilities described in detail in Note 10 to the consolidated financial statements. We are not aware presently of any facts or circumstances related to these that are likely to have a material negative impact on our results of operations or financial condition.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have any material market risk because we have no long-term borrowings.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The response to this item is submitted as a separate section of this report. See page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

No independent public accountant of the company has resigned, indicated any intent to resign or been dismissed as the independent public accountant of the company during the two years ended December 31, 2001 or at any time afterward.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Please refer to the subsection entitled "Proposal 1 - The Election of Directors - Nominees" and "Proposal 1 - The Election of Directors - Executive Officers" in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2002 for information about those individuals nominated as directors and about the executive officers of the company. This information is incorporated into this Item 10 by reference. Information regarding compliance by directors and executive officers of the company and owners of more than 10 percent of our common stock with the reporting requirements of Section 16(a) of the Securities Exchange Act of 1934, as amended, is contained under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement mentioned above. This information is incorporated into this Item 10 by reference.

ITEM 11. EXECUTIVE COMPENSATION

Please refer to the subsection entitled "Proposal 1 - The Election of Directors - Executive Compensation" in the Proxy Statement referred to in Item 10 for information about management compensation. This information is incorporated into this Item 11 by reference, except that we specifically do not incorporate into this Item 11 the information in the subsections entitled "Proposal 1 - The Election of Directors - Executive Compensation - Board Compensation Committee

Report on Executive Compensation" and "Performance Graph."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Please refer to the subsection entitled "Voting - Principal Shareholders, Directors and Certain Executive Officers" in the Proxy Statement referred to in Item 10 for information about the ownership of our $0.01 par value common stock by certain persons. This information is incorporated into this Item 12 by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On January 5, 2000, three officers of the company exercised stock options and issued to the company promissory notes bearing interest at the rate of seven percent per annum in payment of the exercise price. J. Leland Strange, President and Chief Executive Officer of the company and the beneficial owner of greater than 5% of our common stock issued the company a promissory note for $380,000 representing the total exercise price of his options. Bonnie L. Herron, Vice President and Chief Financial Officer, and Francis A. Marks, Vice President, each issued the company a promissory note for $258,750 representing the total exercise price of their respective options. The loans were repaid at various dates in 2000 and 2001 and no amounts are outstanding as of December 31, 2001.

In April 2001, J. Leland Strange, a director, and President and Chief Executive Officer of the company, participated as a common stockholder in the sale of all of the outstanding preferred and common stock of PaySys International, Inc., a former affiliate company, to First Data Corporation ("FDC"). The company sold its interest in PaySys to FDC for $17.8 million as part of the sale transaction. Mr. Strange's shares, which he had owned since 1983 prior to the company's investment in PaySys in 1994, represented less than one percent of PaySys' outstanding shares. The proceeds from the sale of his PaySys stock were $594,000, which was based on the same price per share paid to all common shareholders of PaySys by FDC.

Each of the named officers of the company participated on a pro rata basis with other shareholders of the company pursuant to the company's tender offer on July 12, 2001. In addition, each officer sold shares of common stock to the company at $4.20 per share (which was the closing price of the company's common stock on July 20, 2001, the sale date) to meet the requirements of Section 302 of the Internal Revenue Code for capital gains treatment of shares sold by the officers in the tender offer. J. Leland Strange, a director, President and Chief Executive Officer, and the beneficial owner of more than 5 percent of the company's common stock, sold 47,619 shares for a total sales price of $200,000; Bonnie L. Herron, Vice President and Chief Financial Officer, sold 47,619 shares for a total sales price of $200,000; and Francis A. Marks, Vice President, sold 18,500 shares for a total sales price of $77,700. The officers previously reported these sale transactions on Forms 4 filed with the Securities and Exchange Commission.

On March 14, 2002, the shareholders of Risk Laboratories, a former affiliate of the company, sold their remaining ownership interests to the same buyer that had purchased majority control of Risk in March of 2000. The company and J. William Goodhew, a vice president of the company and minority shareholder in Risk, each sold their respective ownership interests along with all other minority shareholders in the $6 million transaction. Mr. Goodhew's pro rata

share of the sale proceeds was $429,600 and the company's pro rata share was $474,000. The company previously sold most of its ownership in Risk in several transactions totaling $10.7 million in proceeds.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(A) DOCUMENTS FILED AS PART OF THIS REPORT.

1. Financial Statements

The following consolidated financial statements and related reports of independent public accountants are included in this report and are incorporated by reference in Part II, Item 8 hereof. See the Index to Financial Statements and Supplemental Schedules on page F-1 hereof.

Report of Independent Public Accountants
Consolidated Balance Sheets at December 31, 2001 and 2000
Consolidated Statements of Operations for the three years ended December 31, 2001
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income for the three years ended December 31, 2001
Consolidated Statements of Cash Flow for the three years ended December 31, 2001
Notes to Consolidated Financial Statements

2. Financial Statement Schedules

We are including the financial statement schedules listed below in this report. We omitted all other schedules required by certain applicable accounting regulations of the Securities and Exchange Commission because the omitted schedules are not required under the related instructions or do not apply or because we have included the information required in the consolidated financial statements or notes thereto. See the Index to Financial Statements and Supplemental Schedules on page F-1 hereof.

Schedule II - Valuation and Qualifying Accounts and Reserves

Report of Independent Auditors for PaySys International, Inc.
Consolidated Balance Sheets of PaySys at December 31, 2000 and 1999
Consolidated Statements of Operations of PaySys for the three years ended December 31, 2000
Consolidated Statements of Changes in Stockholders' Equity (Deficit) of PaySys for the three years ended December 31, 2000
Consolidated Statements of Cash Flow of PaySys for the three years ended December 31, 2000
Notes to Consolidated Financial Statements of PaySys

Report of Independent Public Accountants for VISaer, Inc.
Consolidated Balance Sheet of VISaer, Inc. at December 31, 2000
Consolidated Statement of Operations of VISaer, Inc. for the year ended December 31, 2000
Consolidated Statement of Comprehensive Loss of VISaer, Inc. for the year ended December 31, 2000
Consolidated Statement of Redeemable Convertible Preferred Stock and

Stockholders' Deficit of VISaer, Inc. for the year ended December 31, 2000
Consolidated Statement of Cash Flow of VISaer, Inc. for the year ended December 31, 2000
Notes to Consolidated Financial Statements of VISaer, Inc.

Report of Independent Public Accountants for VISaer (UK) Limited
Report of Independent Public Accountants for VISaer (IRL) Limited

Report of Independent Public Accountants for Visibility, Inc.
Consolidated Balance Sheets of Visibility at December 31, 1999
Consolidated Statements of Operations of Visibility for the year ended December 31, 1999
Consolidated Statements of Changes in Stockholders' Equity of Visibility for the year ended December 31, 1999
Consolidated Statements of Cash Flow of Visibility for the year ended December 31, 1999
Notes to Consolidated Financial Statements of Visibility, Inc.

Report of Independent Public Accountants for Cirronet, Inc.
Balance Sheet of Cirronet, Inc. at December 31, 2001 (unaudited) and December 31, 2000 (unaudited)
Statement of Operations of Cirronet, Inc. for the two years ended December 31, 2001 (unaudited) and the year ended December 31, 1999 (audited)
Statement of Changes in Stockholders' Equity of Cirronet, Inc. for the two years ended December 31, 2001 (unaudited) and the year ended December 31, 1999 (audited)
Statement of Cash Flow of Cirronet, Inc. for the two years ended December 31, 2001 (unaudited) and the year ended December 31, 1999 (audited)
Notes to Financial Statements of Cirronet, Inc.

3. Exhibits

We are filing the following exhibits with this report or incorporating them by reference to earlier filings. Shareholders may request a copy of any exhibit by contacting Bonnie L. Herron, Secretary, Intelligent Systems Corporation, 4355 Shackleford Road, Norcross, Georgia 30093; telephone (770) 381-2900. There is a charge of $.50 per page to cover expenses of copying and mailing.

3(i) Amended and Restated Articles of Incorporation of the Registrant dated November 14,1991, as amended November 25, 1997. (Incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1991 and to Exhibit 3.1 to the Registrant's Report on Form 8-K dated November 25, 1997.)

3(ii) Bylaws of the Registrant dated June 6, 1997. (Incorporated by reference to Exhibit 3(ii) of the Registrant's Form 10-K/A for the year ended December 31, 1997.)

4.1 Rights Agreement dated as of November 25, 1997 between the Registrant and American Stock Transfer & Trust Company as Rights Agent. (Incorporated by reference to Exhibit 4.1 of the Registrant's Report on Form 8-K dated November 25, 1997 and filed on December 16, 1997.)

4.2 Form of Rights Certificate. (Incorporated by reference to Exhibit 4.2 of the Registrant's Report on Form 8-K dated November 25, 1997 and filed on December 16, 1997.)

10.1 Lease Agreement dated March 11, 1985, between a subsidiary of the Registrant and A.R. Weeks. (Incorporated by reference to Exhibit 10.1 to Intelligent Systems Corporation Annual Report on Form 10-K for the fiscal year ended March 31, 1986.)

10.2 Second Amendment to Lease Agreement dated June 19, 1997 between a subsidiary of the Registrant and A.R. Weeks. (Incorporated by reference to Exhibit 10.2 of the Registrant's Form 10-K for the year ended December 31, 1997.)

10.3 Management Compensation Plans and Arrangements:

(a) Intelligent Systems Corporation 1991 Stock Incentive Plan, amended June 6, 1997.

(b) Intelligent Systems Corporation Change in Control Plan for Officers.

(c) Intelligent Systems Corporation Outside Director's Retirement Plan.

(d) Non-Employee Directors Stock Option Plan.

Item 10.3 (a) is incorporated by reference to Exhibit 4.1 of the Registrant's Form S-8 dated July 25, 1997.

Items 10.3 (b) and (c) are incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-K for the year ended December 31, 1993.

Item 10.3 (d) is incorporated by reference to Exhibit 10.3 to the Registrant's Form 10-K for the year ended December 31, 2000.

10.4 Series A-1 Convertible Preferred Stock Purchase Agreement dated as of July 1, 2001 by and between VISaer, Inc., Intelligent Systems Corporation and other third parties.

10.5 7 X 24 Agreement dated as of June 26, 2001 between United Parcel General Services Co. and VISaer, Inc.

10.6 Warrant to Purchase Common Stock of VISaer, Inc. dated December 7, 2001 issued to United Parcel General Services Co.

10.7 Software License Agreement dated as of April 27, 2001 by and between PaySys International, Inc. and Delos Payment Systems, Inc.

10.8 Trade Secret License Agreement dated as of April 27, 2001 by and between PaySys International, Inc. and Delos Payment Systems, Inc.

10.9 Non-Competition Agreement made as of April 27, 2001 by and between First Data Corporation, J. Leland Strange and PaySys International, Inc.

10.10 Subscription Agreement dated August 23, 2001 between the Registrant and Delos Payment Systems, Inc.

21.1 List of subsidiaries of Registrant.

23.1 Consent of Arthur Andersen LLP.

23.2 Consent of Ernst and Young LLP.

23.3 Consent of Moody, Famiglietti and Andronico LLP.

23.4 Consent of Hacker Young.

23.5 Consent of Arthur Andersen.

23.6 Consent of Arthur Andersen LLP.

(B) REPORTS ON FORM 8-K.

We did not file any reports on Form 8-K during the quarter ended December 31, 2001.

(C) SEE ITEM 14(A)(3) ABOVE.

(D) SEE ITEM 14(A)(2) ABOVE.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTELLIGENT SYSTEMS CORPORATION
Registrant

Date: March 22, 2002

By: /s/ J. Leland Strange
J. Leland Strange
Chairman of the Board, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

SIGNATURE	CAPACITY	DATE
/s/ J. Leland Strange J. Leland Strange	Chairman of the Board, President, Chief Executive Officer and Director (Principal Executive Officer)	March 22, 2
/s/ Bonnie L. Herron Bonnie L. Herron	Chief Financial Officer (Principal Accounting and Financial Officer)	March 22, 2
/s/ Donald A. McMahon Donald A. McMahon	Director	March 22, 2
/s/ James V. Napier	Director	March 22, 2

James V. Napier

/s/ John B. Peatman John B. Peatman	Director	March 22, 2
/s/ Parker H. Petit Parker H. Petit	Director	March 22, 2

INTELLIGENT SYSTEMS CORPORATION
INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULES

The following consolidated financial statements and schedules of the Registrant and its subsidiaries are submitted herewith in response to Item 8:

FINANCIAL STATEMENTS:

Report of Independent Public Accountants...
Consolidated Balance Sheets - December 31, 2001 and 2000....................................
Consolidated Statements of Operations -
Three Years Ended December 31, 2001...
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income -
Three Years Ended December 31, 2001...
Consolidated Statements of Cash Flow -
Three Years Ended December 31, 2001...
Notes to Consolidated Financial Statements..

FINANCIAL STATEMENT SCHEDULES:

The following supplemental schedules of the Registrant and its subsidiaries are submitted herewith in response to Item 14(a)(2):

Schedule II - Valuation and Qualifying Accounts and Reserves................................
Report of Independent Auditors for PaySys International, Inc................................
Consolidated Balance Sheets of PaySys at December 31, 2000 and 1999.....................
Consolidated Statements of Operations of PaySys for the three years ended December 31, 20
Consolidated Statements of Changes in Shareholders' Equity (Deficit) of PaySys for the th
ended December 31, 2000...
Consolidated Statements of Cash Flow of PaySys for the three years ended December 31, 200
Notes to Consolidated Financial Statements of PaySys....................................
Report of Independent Public Accountants for VISaer, Inc....................................
Consolidated Balance Sheet of VISaer, Inc. at December 31, 2000.........................
Consolidated Statement of Operations of VISaer, Inc. for the year ended December 31, 2000
Consolidated Statement of Comprehensive Loss of VISaer, Inc. for the year ended
December 31, 2000...
Consolidated Statement of Redeemable Convertible Preferred Stock and Stockholders' Defici
VISaer, Inc. for the year ended December 31, 2000.......................................
Consolidated Statement of Cash Flow of VISaer, Inc. for the year ended December 31, 2000.
Notes to Consolidated Financial Statements of VISaer, Inc. ....

Report of Independent Public Accountants for VISaer (UK) Limited..........................
Report of Independent Public Accountants for VISaer (IRL) Limited.........................
Report of Independent Public Accountants for Visibility, Inc..............................
Consolidated Balance Sheets of Visibility at December 31, 1999..........................
Consolidated Statements of Operations of Visibility for the year ended December 31, 1999.
Consolidated Statements of Changes in Stockholders' Equity of Visibility for the year end
December 31, 1999...
Consolidated Statements of Cash Flow of Visibility for the year ended December 31, 1999..
Notes to Consolidated Financial Statements of Visibility, Inc...........................
Report of Independent Public Accountants for Cirronet, Inc................................
Balance Sheet of Cirronet, Inc. at December 31, 2001 and 2000 (unaudited)...............
Statement of Operations of Cirronet, Inc. for the two years ended December 31, 2001 (unau
year ended December 31, 1999 (audited)..
Statement of Changes in Shareholders' Equity of Cirronet, Inc. for the two years ended De
(unaudited) and the year ended December 31, 1999 (audited)..............................
Statement of Cash Flow of Cirronet, Inc. for the two years ended December 31, 2001 (unaud
and the year ended December 31, 1999 (audited)..
Notes to Financial Statements of Cirronet, Inc..

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

TO INTELLIGENT SYSTEMS CORPORATION:

We have audited the accompanying consolidated balance sheets of Intelligent Systems Corporation (a Georgia corporation) and its subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. The summarized financial data for PaySys International, Inc. contained in Note 4 are based on the financial statements of PaySys International, Inc. which were audited by other auditors. Their report has been furnished to us and our opinion, insofar as it relates to the data in Note 4, is based solely on the report of the other auditors. We did not audit the December 31, 2000 financial statements of VISaer, Inc., an investment which is reflected in the accompanying financial statements using the equity method of accounting. The investment in VISaer, Inc. represents 16 percent of total assets in 2000, and the equity in 2000 net loss represents 9 percent of consolidated net income for 2000. The statements of PaySys International, Inc. and VISaer, Inc. were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for PaySys International, Inc. and VISaer, Inc., is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Intelligent Systems Corporation and its subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule II in Item 14(a)(2) is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Atlanta, Georgia
March 1, 2002

INTELLIGENT SYSTEMS CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands except share amounts)

AS OF DECEMBER 31,	2001
ASSETS	
Current assets:	
Cash	$ 12,
Accounts receivable, net	2,
Notes and interest receivable	
Inventories	
Other current assets	
Total current assets	15,
Long-term investments	7,
Long-term notes receivable	
Property and equipment, at cost less accumulated depreciation	
Intangibles, net	2,
Other assets, net	
Total assets	$ 26,
LIABILITIES AND STOCKHOLDERS' EQUITY	

Current liabilities:	
Short-term borrowings	$
Accounts payable	1,
Deferred revenue	1,
Deferred gain	1,
Accrued expenses and other current liabilities	1,
Total current liabilities	5,
Deferred revenue, net of current portion	2,
Other long-term liabilities	
Total long term liabilities	2,
Commitments and contingencies (note 10)	
Redeemable preferred stock of subsidiary	
Stockholders' equity:	
Common stock, $.01 par value, 20,000,000 shares authorized, 4,495,530 and 5,623,784 issued and outstanding at December 31, 2001 and 2000, respectively	
Paid-in capital	18,
Accumulated other comprehensive loss	(
Accumulated deficit	(
Total stockholders' equity	17,
Total liabilities and stockholders' equity	$ 26,

The accompanying notes are an integral part of these consolidated balance sheets.

INTELLIGENT SYSTEMS CORPORATION
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INTELLIGENT SYSTEMS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except share amounts)

YEAR ENDED DECEMBER 31,	2001	20
Revenue		
Products	$ 5,321	$
Services	3,397	
Total revenue	8,718	
Cost of sales		
Products	2,633	
Services	1,439	
Total cost of sales	4,072	
Gross profit	4,646	
Expenses		

Marketing	2,090	
General & administrative	9,605	
Research & development	3,371	
Loss from operations	(10,420)	
Other income		
Interest income (expense), net	1,017	
Investment income, net	19,902	
Equity losses of affiliate companies	(2,173)	
Other income (loss), net	960	
Income before income tax provision and minority interest	9,286	
Income tax provision	173	
Income before minority interest	9,113	
Minority interest	--	
Net income	$ 9,113	$
Basic net income per share	$ 1.78	$
Diluted net income per share	$ 1.77	$
Basic weighted average shares outstanding	5,108,413	5,6
Diluted weighted average shares outstanding	5,145,691	5,6

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

INTELLIGENT SYSTEMS CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(in thousands except share amounts)

	YEAR END	
	2001	
STOCKHOLDERS' EQUITY		
COMMON STOCK, NUMBER OF SHARES, beginning of year	5,623,784	
Exercise of options during year	3,334	
Purchase and retirement of stock	(1,131,588)	
End of year	4,495,530	
COMMON STOCK, AMOUNT, beginning of year	$ 56	$
Exercise of options during year	--	
Purchase and retirement of stock	(11)	
End of year	45	

PAID-IN CAPITAL, beginning of year	24,216	
Proceeds from options exercised	14	
Purchase and retirement of stock	(5,792)	
End of year	18,438	
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), beginning of year	(215)	
Foreign currency translation adjustment during year	4	
Change in accumulated other comprehensive income (loss)	(144)	
End of year	(355)	
ACCUMULATED DEFICIT, beginning of year	(9,383)	
Dividends paid	--	
Net income	9,113	
End of year	(270)	
TOTAL STOCKHOLDERS' EQUITY	$ 17,858	$
COMPREHENSIVE INCOME		
Net income	$ 9,113	$
Other comprehensive income:		
Foreign currency translation adjustments	4	
Unrealized gain (loss)	(144)	
Comprehensive income	$ 8,973	$

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

INTELLIGENT SYSTEMS CORPORATION
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INTELLIGENT SYSTEMS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOW
(in thousands)

	YEAR ENDED	
	2001	2000
CASH PROVIDED BY (USED FOR):		
OPERATIONS:		
Net income	$ 9,113	$ 8,215
Adjustments to reconcile net income to net cash used for operating activities, net of effects of acquisitions and dispositions:		
Depreciation and amortization	6,595	314
Investment income, net	(19,902)	(9,665
Equity loss of affiliate companies	2,173	771
Changes in operating assets and liabilities, net of effects of acquisition		
Accounts receivable	(33)	249
Inventories	(72)	(149

Other current assets	126	66
Accounts payable	(166)	(87
Accrued expenses and other current liabilities	149	(124
Cash used for continuing operations	(2,017)	(410
INVESTING ACTIVITIES:		
Proceeds from sales of investments	20,540	10,291
Acquisition of company, net of cash acquired	81	--
Increase (decrease) in minority interests	--	5
Acquisitions of long-term investments	(2,806)	(3,628
Repayments under notes and interest receivable	5,105	377
Advances under notes and interest receivable	(2,087)	(4,533
Purchases of property and equipment, net	(95)	(111
Cash provided by investing activities	20,738	2,401
FINANCING ACTIVITIES:		
Borrowings under short-term borrowing arrangements	889	1,503
Repayments under short-term borrowings arrangements	(2,393)	(763
Payment of dividends to stockholders	--	(2,956
Purchase and retirement of stock	(5,803)	(112
Exercise of stock options	14	194
Foreign currency translation adjustment	4	--
Cash used for financing activities	(7,289)	(2,134
Net increase (decrease) in cash	11,432	(143
Cash at beginning of year	594	737
Cash at end of year	$ 12,026	$ 594
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for interest	$ 52	$ 59
Cash paid during the year for taxes	577	--

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

NOTE 1

ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Intelligent Systems Corporation, a Georgia corporation, was formed in November 1991 to acquire through merger the business, net assets and operations of Intelligent Systems Master, L.P. In this document, terms such as the company, we, us, and ISC refer to Intelligent Systems Corporation.

Nature of Operations - Our business is to create, operate and invest in businesses which we believe have promising growth potential. Consolidated companies (in which we have majority ownership and control) are principally engaged in two industries: information technology products and services and industrial products. Operations in information technology products and services, which include our VISaer and QS Technologies subsidiaries, include

development and sales of software licenses and related professional services and software maintenance contracts. Operations in the industrial product segment include the manufacture and sale of bio-remediating parts washers by our ChemFree subsidiary. In prior periods, through November 2000, we also were involved in health care services. These operations are explained in further detail in Note 18. Our affiliate companies (in which we have a minority ownership) are mainly involved in the information technology industry.

Use of Estimates - In preparing the financial statements in conformity with accounting principles generally accepted in the United States, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Consolidation - The financial statements include the accounts of Intelligent Systems Corporation and its majority owned and controlled U.S. and non-U.S. subsidiary companies after elimination of material accounts and transactions between our subsidiaries.

Investments - For entities in which we have 20 to 50 percent ownership interest and do not exert control, we account for these investments by the equity method. We account for investments of less than 20 percent in non-marketable equity securities at the lower of cost or market. When calculating gain or loss on the sale of an investment, we use the average cost basis of the securities. Marketable securities are accounted for in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS No. 115). At December 31, 2001, the aggregate fair market value of our available-for-sale securities consisted of equity securities and totaled $2.0 million. At December 31, 2000, the aggregate fair market value of our available-for-sale securities consisted of equity securities and totaled $2.3 million. These amounts include net unrealized holding losses of $359,000 and $215,000 as of December 31, 2001 and 2000, respectively. These amounts are reflected as a separate component of stockholders' equity.

Translation of Foreign Currencies - We consider that local currencies are the functional currencies for foreign operations. We translate assets and liabilities to U.S. dollars at period-end exchange rates. We translate income and expense items at average rates of exchange prevailing during the period. Translation adjustments are accumulated as a separate component of stockholders' equity. Gains and losses that result from foreign currency transactions are recorded in the consolidated statement of operations.

Cash - We consider all highly liquid instruments with maturities of less than 90 days to be cash.

Inventories - We state the value of inventories at the lower of cost or market determined on a first-in first-out basis. Cost includes labor, materials and production overhead. Market is defined as net realizable value.

Property and Equipment - Property and equipment are carried at cost less accumulated depreciation. The cost of each major class of property and equipment at December 31, 2001 and 2000 is as follows:

(in thousands)	2001	2000
Operating equipment	$1,397	$974
Furniture and fixtures	199	117

Leasehold improvements	241	33

For financial reporting purposes, with the exception of the VISaer subsidiary which uses the straight-line method, we depreciate these assets using the 150 percent declining balance method over the estimated lives of the assets, as follows:

CLASSIFICATION	USEFUL LIFE IN YEARS
Operating equipment	3-5
Furniture & fixtures	5-7
Leasehold improvements	1-7

Accumulated depreciation and amortization was $1.2 million and $642,000 at December 31, 2001 and 2000, respectively. Depreciation expense was $307,000, $316,000 and $332,000 in 2001, 2000 and 1999, respectively. These expenses are included in general and administrative expenses.

Leased Equipment - In the Industrial Products segment, certain equipment is leased to customers. At December 31, 2002, the cost and carrying value of equipment leased to customers is $488,000 and $101,000, respectively, and accumulated depreciation associated with leased equipment is $387,000. The minimum future lease revenue under non-cancelable contracts is $1.25 million at December 31, 2001. There is no contingent rental income under the leases.

Other Assets - Other assets are carried at cost net of related amortization. Effective July 1, 2001, we account for acquisitions in accordance with Statement of Financial Accounting Standards No. 141, "Accounting for Business Combinations" (SFAS 141) and Statement of Financial Accounting Standards No. 142, "Accounting for Intangible Assets" (SFAS 142). Our policy is to write off the asset and accumulated amortization for fully amortized intangibles. Periodically we review the values assigned to long-lived assets to determine whether they have been permanently impaired. To measure whether long-lived assets are recoverable, we use an estimate of the undiscounted cash flows of the applicable entity over the remaining life of the asset. At September 30, 2001, we determined the long-lived assets associated with our VISaer subsidiary were impaired under SFAS 121 (see Note 2). Accordingly we expensed $6.0 million related to goodwill in general and administrative expense which is reflected in the statements of operations for the year ended December 30, 2001. The carrying value of intangibles at December 31, 2001 is $2.3 million, of which $1.9 million is goodwill. Also in the year ended December 31, 2001, we expensed $425,000 of purchased research and development related to the acquisition of VISaer (see Note 2). In 2001, 2000 and 1999, we recorded total intangible amortization expense of approximately $92,000, $29,000 and $15,000, respectively. Accumulated amortization of intangibles totaled $92,000 and $0 at December 31, 2001 and 2000, respectively.

Accrued Expenses and Other Liabilities - Accrued expenses and other liabilities

at December 31, 2001 and 2000 consist of the following:

(in thousands)	2001	2000
Income taxes payable	$ --	$ 203
Accrued payroll	761	242
Other accrued expenses	803	416

Warranty Costs - We accrue the estimated costs associated with product warranties as an expense in the period the related sales are recognized.

Revenue Recognition - Product revenue consists of fees from software licenses and sales or leases of industrial products. Service revenue consists of fees for implementation, consulting, training, maintenance and support for software products and health care services.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition issues. The Company has reviewed its revenue recognition policies and determined that they are in compliance with SAB 101.

We recognize revenue for industrial products when products are shipped, at which time title transfers to the customer. There are no remaining future obligations and delivery occurs upon shipment. We provide for estimated sales returns in the period in which the sales are recorded. For leased equipment, we recognize revenue monthly at the contracted monthly rate during the term of the lease.

We recognize software fees in accordance with Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position No. 98-9, "Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"). Under SOP 97-2, we recognize software license fees when the following criteria are met: (1) a signed contract is obtained; (2) delivery of the product has occurred; (3) the license fee is fixed or determinable; and (4) collectibility is

probable. SOP 98-9 requires recognition of revenue using the "residual method" when (1) there is vendor-specific objective evidence of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting; (2) vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement; and (3) all revenue-recognition criteria in SOP 97-2 other than the requirement for vendor-specific objective evidence of the fair value of each delivered element of the arrangement are satisfied. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the license fee is recognized as revenue. SOP 98-9 was effective for transactions entered into after March 15, 1999, and we adopted the residual method for such arrangements at that time. For those contracts that contain significant production, modification and/or customization,

software license fees are recognized utilizing contract accounting (ARB No. 45), using the relevant guidance in SOP 81-1.

For percentage of completion contracts we measure the progress toward completion and recognize the software license fees based upon input measures (i.e. in the same proportion that the amount of labor hours incurred to date bears to the total estimated labor hours required for the contract). If reliable estimates cannot be determined, we follow the completed contract method. Under the completed contract method, all revenue is deferred until the customer has accepted the software and any refund rights have expired.

Service revenue related to implementation, consulting, training and healthcare services is recognized when the services are performed. Service revenue related to software maintenance and support contracts is recognized on a straight-line basis over the life of the contract (typically one year).

Deferred Revenue - Deferred revenue, net of current portion, consists of advance payments from one customer and is being accounted for on a completed-contract basis. As of December 31, 2001, the Company had an outstanding balance of $2,596,000. The Company does not anticipate any loss under this contract.

Fair Value of Financial Instruments - The carrying value of cash, accounts receivable, accounts payable and other financial instruments included in the accompanying consolidated balance sheets approximates their fair value principally due to the short-term maturity of these instruments.

Cost of Sales - Cost of sales for product revenue includes direct material, direct labor, production overhead and third party license fees. Cost of sales for service revenue includes direct cost of services rendered.

Software Development Expense - We have evaluated the establishment of technological feasibility of our products in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed. We sell products in markets that are subject to rapid technological change, new product development and changing customer needs; accordingly, we have concluded that technological feasibility is not established until the development stage of the product is nearly complete. We define technological feasibility as the completion of a working model. The time period during which cost could be capitalized, from the point of reaching technological feasibility until the time of general product release, is very short and, consequently, the amounts that could be capitalized are not material to our financial position or results of operations. Therefore, we have charged all such costs to research and development in the period incurred.

In accordance with AICPA SOP No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, we have expensed all cost incurred in the preliminary project stage for software developed for internal use. We capitalize all direct costs of materials and services consumed in developing or obtaining internal use software. All costs incurred for upgrades, maintenance and enhancements that do not result in additional functionality are expensed. During the three years ended December 31, 2001, we did not capitalize any internal use software costs.

New Accounting Pronouncements - In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a Replacement of FASB Statement No. 125." This Statement revises the standards for accounting for securitizations and other transfers of financial assets and collateral. This statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. The adoption of this Statement did not have a significant

impact on our financial statements.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 141, "Business Combinations" (SFAS 141). This Statement requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. See Note 2 for the impact related to the acquisition of VISaer, Inc. Also in July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). This Statement requires that goodwill and certain intangible assets, including those recorded in past business combinations, no longer be amortized to earnings, but instead be tested for impairment at least annually. The adoption of SFAS No. 142 by the Company did not have a significant impact on our financial statements. For acquisitions completed after June 30, 2001, the Statement requires that goodwill not be amortized to earnings beginning immediately. Related to the acquisition of VISaer, Inc. (Note 2), we recorded $1.86 million of goodwill, after related charges, of which no amortization expense is reflected in the statement of operations.

In August 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We have determined that the adoption of this Statement will not have an impact on our financial statements.

NOTE 2

ACQUISITION

VISaer, Inc. - As of June 30, 2001, we owned 40% of VISaer, Inc. ("VISaer") and accounted for our investment under the equity method of accounting. At that date, we had a carrying value for VISaer of $2.86 million in long-term investments and $1.68 million in principal and interest outstanding under affiliate notes receivable from VISaer. VISaer, a software company that designs and sells software that automates the maintenance, repair and overhaul (MRO) operations of airlines, is the successor company of Visibility, Inc., an enterprise resource planning (ERP) company whose operations were spun off a year ago in June 2000. Effective July 1, 2001, in an unplanned restructuring transaction involving all preferred shareholders of VISaer, we converted $956,000 of our VISaer note receivable into a new series of preferred stock of VISaer. In addition, VISaer repaid the balance of $725,000 owed to us shortly after the restructuring was completed.

The debt to equity conversion in July resulted in ISC taking control of VISaer. Our ownership of VISaer increased from 40% to 65%, and we account for the transaction as a "step" acquisition. For financial reporting periods after July 1, 2001, we account for VISaer under the consolidation method. The accounting treatment for the "step" acquisition and related purchase accounting of VISaer had the result of immediately creating $8.8 million in intangible assets for financial reporting purposes. In accordance with SFAS 141, based on third party valuations, we identified and valued the following intangible assets: existing software technology ($2.0 million), in-process research and development ($1.7 million) and a favorable lease contract ($200,000). At the time of the acquisition we recorded 25% of such amounts to reflect the amount associated

with our acquisition of an additional 25% "step" of VISaer. The recorded amount for existing software technology ($500,000) is being amortized over its estimated useful life of three years and the recorded amount for the favorable lease contract ($50,000) is being amortized over the remaining term of the lease (through July 2004). We immediately expensed $425,000 (representing 4.8% of the $8.8 million of total intangibles) related to purchased research and development projects that had not reached technological feasibility and that did not have an alternative future use. This amount is included in research and development expense in the accompanying financial statements. The remaining excess intangible value in the amount of $7.83 million was booked as goodwill at July 1, 2001.

Post-acquisition Write-down of Goodwill - At September 30, 2001, as a result of the terrorist attacks on September 11, 2001 which have directly impacted the aerospace industry into which VISaer sells its software products, we evaluated the extent to which the VISaer reporting unit might be impaired. An analysis by a third party based on an undiscounted cash flow model determined that under SFAS 121, the long-lived assets associated with VISaer were impaired. Based upon this appraisal, we assessed the total fair value of VISaer at September 30, 2001 to be $3.7 million. Based on our 65% ownership, the value of our

ownership was $2.4 million. We expensed $6.0 million related to goodwill. The one-time charge is included in general and administrative expense in the consolidated financial statements for the year ended December 31, 2001. Despite the write-down, we are committed to the VISaer business plan and have agreed to assist VISaer with working capital needs, if any, during 2002.

NOTE 3

SALES OF ASSETS

PaySys International, Inc. - On April 27, 2001, we sold our 32 percent ownership interest in PaySys, an affiliate company, to First Data Corporation. In exchange for the sale of all of our shares of PaySys common stock, we received cash proceeds of $17.8 million and recorded a pretax gain of $17.8 million. In addition, PaySys repaid $4.3 million in principal and interest related to short-term bridge loans. In addition, an escrow fund totaling $20.0 million was set aside for potential liabilities that may arise after the closing of the sale. The balance of the fund, after payment of any and all claims, will be distributed pro rata to PaySys shareholders, including us, as additional sale proceeds at various time periods over the next four years.

Immediately prior to the sale to First Data Corporation, PaySys spun off two subsidiaries to its shareholders. Accordingly, we own approximately 27 percent of Delos Payment Systems, Inc. and 31 percent of dbbAPPS, Inc., both development stage companies that are continuing to develop and market a proprietary software operating platform and application software that had been under development by PaySys. We did not record a gain on the distribution to us of an interest in these two companies. Rather, due to uncertainty regarding the two early stage companies, we booked a valuation reserve equal to the net asset value and goodwill associated with our pro rata share of the value of our interest in Delos Payment Systems and dbbAPPS. In the fourth quarter of 2001, in accordance with APB18, we classified a secured loan in the amount of $1.5 million to Delos Payment Systems as additional investment. At the same time, we recaptured $1.42 million in losses related to our pro rata share of cumulative unrecorded losses. This loss is recorded in equity loss in affiliates in the

consolidated statements of operations. The carrying value of Delos at year-end is $80,000 and of dbbAPPS is zero.

HeadHunter.net - In the third quarter ended September 30, 2001, we sold 90,228 shares of common stock (representing all of our interest) of HeadHunter.net. We originally acquired the shares in exchange for our holdings in privately held MiracleWorker.net in August 2000. We received $821,000 cash and recognized a gain of $471,000 on an original cost basis of $350,000.

PsyCare America, LLC - On November 1, 2000, we sold certain operating assets of our subsidiary PsyCare America, LLC, consisting mainly of contracts and intellectual property, and closed the remaining operations. We sold the assets to iExalt, Inc. in exchange for 200,000 shares of common stock of iExalt, a publicly traded company, and may receive additional shares based on the trading price of the iExalt stock on the second anniversary of the transaction.

Risk Laboratories, LLC - On March 21, 2000, we sold part of our interest in Risk Laboratories, LLC in a private transaction. We sold 2,310,000 units for $8.8 million in cash and a gain of $8.6 million. On January 18, 2001, we sold 214,273 units of Risk to the same buyer for a total of $900,000 cash and recorded a gain of $893,000 based on a cost basis of $7,000. At the same time, we acquired 107,137 common units from Risk for a total acquisition price of $450,000. Concurrent with the purchase of these units, we recaptured $450,000 in losses related to our pro rata share of cumulative unrecorded losses. This loss is recorded in equity loss in affiliates in the accompanying consolidated statement of operations for 2001. On May 3, 2001, we sold an additional 257,127 common units of Risk to the same buyer. We received $1.0 million cash and recorded a second quarter gain of $1.0 million on a cost basis of zero. At December 31, 2001, we retain 259,253 common units, representing approximately 2.7% of Risk.

Primus Knowledge System, Inc. - In January 2000, a company in which we held a minority equity position was acquired by Primus Knowledge Solutions, Inc., a publicly traded company. We received 66,431 shares of Primus common stock in exchange for our interest in the acquired company. The shares were sold at various times during 2000, resulting in a net gain of $775,000 and cash of $1.3 million.

S1 Corporation - At various times during 2000, we sold a total of 9,515 shares of S1 Corporation common stock, which had been received as consideration for our shares of stock in VerticalOne

Corporation upon the merger of the two companies in 1999. We realized net gains of $249,000 and cash of $296,000 on the sales of S1 stock.

MediaMetrix, Inc. - As a result of a merger between Relevant Knowledge (a company in which we were a minority investor) and MediaMetrix in 1998, we acquired shares of MediaMetrix stock. We sold the shares in the public market on November 6, 1999, realizing a gain of $995,000 on the sale.

Novient, Inc. - In the first quarter of 1999, we sold 66,500 shares of preferred stock of Novient, Inc., in a private transaction, recognizing a gain of $233,000 and netting $286,000 in cash. At December 31, 2001 we hold 227,250 shares of preferred stock in the private company.

InterQuad Services - Effective February 1, 1999, we sold our ownership in the

InterQuad Services subsidiary. We sold our interest in return for a 19 percent interest in a privately held U.K. company whose principal asset is a 49 percent ownership in InterQuad Group. InterQuad Group is a privately held U.K. based company that provides computer hardware, software, training and consulting services to businesses.

Information Advantage, Inc. - In January 1999, we sold 95,449 shares of common stock of Information Advantage (formerly IQ Software, an affiliate company acquired by Information Advantage in 1998). We recorded a gain on the sale of $814,000.

NOTE 4

INVESTMENTS IN AFFILIATES

PaySys International, Inc. - Prior to the sale of PaySys on April 27, 2001 (refer to Note 3), we owned a 32.6 percent interest in PaySys International, Inc., a software company accounted for using the equity method of accounting. In 1997, in accordance with the equity method of accounting, we recorded $3.0 million representing our pro rata share of PaySys losses, thus reducing the carrying value of our $3.0 million investment to zero. In subsequent periods, we did not record any additional losses or income related to PaySys operations. No cash dividends were received from the affiliate during 2001 and 2000.

The following table contains the summarized financial information of PaySys.

YEAR ENDED DECEMBER 31,		
(in thousands)	2000	1999
Current assets	$ 8,747	$18,929
Current liabilities	31,992	18,947
Noncurrent assets	4,978	4,960
Noncurrent liabilities	12,730	16,370
Net sales	$ 40,477	$50,068
Operating income (loss)	(20,653)	902
Net loss	(24,527)	(1,706)

* There is no data provided for 2001 because we sold our PaySys stock in April 2001. See Note 3.

VISaer, Inc. - Prior to the acquisition of VISaer, Inc. (see Note 2), we owned a 40.2 percent interest in VISaer, Inc. The investment was classified as an affiliate and accounted for using the equity method of accounting because we did not exert control over the company prior to the acquisition. Since the acquisition, we have consolidated the results of VISaer. Our pro rata share of VISaer loss was $(116,000) for the six months ended June 30, 2001 and $(720,000) and $(1,418,000) for fiscal years 2000 and 1999, respectively. No cash dividends were received from the affiliate in 2001 or 2000.

The following table contains the summarized financial information of VISaer.

YEAR ENDED DECEMBER 31,

(in thousands)	2001*	2000**	1999**
Current assets	$ 1,465	$ 1,036	$ 9,177
Current liabilities	5,184	7,794	16,862
Noncurrent assets	335	257	1,108
Noncurrent liabilities	2,677	2,632	1,972
Net sales	$ 4,821	$11,752	$24,210
Operating loss	(3,558)	(2,757)	(3,636)
Net loss	(184)	(583)	(4,225)

* We have consolidated VISaer since July 1, 2001.

** Includes results of business line sold in July 2000.

Cirronet, Inc. - At December 31, 2001, we owned an 18.2 percent interest in Cirronet, Inc. (formerly Digital Wireless Corporation), a private company involved in wireless telecommunication products that is accounted for using the cost method of accounting.

During 2000, we lost the ability to exert significant influence and therefore converted from the equity to the cost method of accounting. Our pro rata share of Cirronet's income (loss) in 2000 and 1999 was

($28,000) and $184,000, respectively. No dividends were received from the affiliate in 2001 or 2000.

The following table contains the summarized financial information of Cirronet.

YEAR ENDED DECEMBER 31,

(in thousands)	2001 (unaudited)	2000 (unaudited)	1999 (audited)
Current assets	$ 3,121	$3,279	$2,785
Current liabilities	576	911	439
Noncurrent assets	490	364	115
Noncurrent liabilities	166	84	103
Net sales	$8,821	$6,241	$4,471
Operating income (loss)	111	(117)	1,006
Net income (loss)	199	(38)	794

NOTE 5

INVESTMENTS

The following summarizes our ownership interest in certain non-significant companies included in our long-term investments. At December 31, 2001, our ownership interest in each of the named companies was as follows: Alliance Technology Ventures (