Summer Infant, Inc.
Form 10-K
March 10, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT of 1934**

For the fiscal year ended December 31, 2009

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to
Commission File No. 001-33346

SUMMER INFANT, INC.

Delaware	**20-1994619**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
1275 Park East Drive, Woonsocket, Rhode Island	**02895**
(Address of Principal Executive Offices)	(Zip Code)

(401) 671-6550
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of Exchange on which registered**
Common Stock, Par Value $.0001	Nasdaq Capital Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO ý

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 ý NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceeding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o

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. o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ý

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of December 31, 2009 was approximately $50,991,000.

The number of shares outstanding of the registrant's common stock as of February 1, 2010 was 15,437,477 (excluding unvested restricted shares that have been issued to employees).

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FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009

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FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K contains, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and are subject to a number of factors and uncertainties, which could cause actual results to differ materially from those described in such statements. We caution investors that actual results or business conditions may differ materially from those projected or suggested in forward-looking statements as a result of various factors including, but not limited to, the risk factors described below. We cannot assure you that we have identified all the factors that create uncertainties. Readers should not place undue reliance on forward-looking statements.

PART I

Item 1. Business

Background

On March 6, 2007, under an Agreement and Plans of Reorganization, dated as of September 1, 2006 ("Acquisition Agreement"), KBL Healthcare Acquisition Corp. II ("KBL"), and its wholly owned subsidiary, SII Acquisition Corp. ("Acquisition Sub"), consummated a transaction by which (i) Summer Infant, Inc. ("SII") was merged with and into Acquisition Sub and (ii) all of the outstanding capital stock of each of Summer Infant Europe, Limited ("SIE") and Summer Infant Asia, Ltd. ("SIA" and, collectively, with SII and SIE, the "Targets") was acquired directly by KBL. As used in this Report, the term "Summer" includes each of the Targets. As used in this Report, the term "Company" means the registrant on a post-acquisition basis. On March 7, 2007, the securities of the Company commenced listing on the Nasdaq Capital Market under the symbols SUMR (common stock), SUMRW (warrants) and SUMRU (units).

Effective upon closing, the Company changed its name to Summer Infant, Inc. and SII changed its name to Summer Infant (USA), Inc. Thus, the Company is now a holding company called Summer Infant, Inc. operating through its wholly-owned subsidiaries, Summer Infant (USA), Inc., Summer Infant Europe, Limited ("SIE"), Summer Infant Canada, Ltd. ("SIC") and Summer Infant Asia, Ltd. ("SIA").

General

We are a designer, marketer, and distributor of branded juvenile health, safety and wellness products which are sold principally to large North American and UK retailers. We currently have more than 80 proprietary products in various product categories including nursery audio/video monitors, safety gates, durable bath products, bed rails, related health and safety products, booster and potty seats, bouncers and a product line of soft goods/bedding. In the past two years, the Company has completed several acquisitions and therefore added items such as cribs, baby gear, infant sleep positioners, head supports, portable changing pads, as well as nursery and feeding accessories. Our products are sold primarily to U.S. retailers including Babies R Us, Target, KMart, Buy Buy Baby, Meijer, Baby Depot (Burlington Coat Factory) and Wal-Mart.

We maintain through SIE a sales, marketing and distribution office in England, which services the United Kingdom and other parts of Europe. SIE's largest customers are Mothercare, Toys R Us, Argos, and Tesco. In 2009, Summer Infant (USA), including international sales managed out of the U.S., accounted for approximately 90% of total Company revenue.

We maintain through SIA a product development, sales, engineering and quality assurance office.

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Strategy

Our strategy is to grow our sales through a variety of methods, including:

- increased product penetration (more products at each store);
- increased store penetration (more stores within each retail customer);
- new products (at existing and new customers);
- new mass merchant retail customers;
- new distribution channels (food and drug chains, price clubs, home centers, web-based retailers);
- new geographies (international expansion);
- new product categories; and
- acquisitions.

We have been able to grow our annual revenues historically through a combination of all of the above factors. Each year, we have been able to expand the number of products in our main distribution channel, mass merchant retailers, and have also added new customers each year. Therefore, even without new product introductions, we could grow our business by simply selling more of our existing product line to existing customers.

In the future, our growth strategy will be to continue to develop and sell new products to our existing customer base, sell new and existing products to new customers (or expand relationships with existing customers), to expand our sales of products from our soft goods product line, and to expand in the UK and in other geographic regions (including Japan, Mexico and Australia, among others). In addition, there are a number of potential acquisition candidates that could be pursued in order to obtain new innovative products, new product categories, new retail customers or new sales territories. There are approximately 400 active juvenile product companies, of which approximately 300 have less than $10 million in sales. In addition, there are various product categories that we do not currently compete in, including car seats, walkers, strollers, and other categories. We may look to develop our own products in these categories or attempt to gain entrance into these categories through acquisitions.

Products

We sell products in a number of different categories, including: Infant bath products; safety gates; audio and video monitors; high chairs and other baby "gear"; infant bedding; cribs and nursery furniture; swaddling blankets; and many other categories. Most of the products are sold under the Summer Infant brand; the Company also has several licensing arrangements to sell products under different brands. No single product generated more than 10% of sales for the year ended December 31, 2009.

Product Development and Design

Our management believes that product development is a critical element of our strategy and success to date. Our product strategy is to produce proprietary products that provide distinctive benefits, are visually appealing, provide convenience and will appeal to the mid-tier and upper-tier buyers. Our U.S. retailers are strategically motivated to buy innovative, up-market products. Our main product development efforts are located at our Rhode Island corporate office, but we also have development efforts in China, Colorado, South Carolina, Pennsylvania, and the United Kingdom.

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Suppliers and Manufacturing

Except for certain injection-molded bath tubs, potty seats and gates, which are manufactured in the U.S., substantially all of our other products are manufactured in Asia (particularly China). We use many different suppliers and we own our molds. Therefore, we are not dependent on any one manufacturer. SIA provides us with a local sourcing presence and the ability to oversee quality, electronic engineering and other issues that may arise during production.

Transportation of Asia-made goods to our warehouses typically takes three to four weeks, depending on the location of the warehouse. We maintain our inventory at warehouses located in the United States, Canada, Asia, and the United Kingdom. Most of our customers pick up their goods at regional warehouses. We also use UPS and other common carriers to arrange shipments to customers who request such arrangements, primarily smaller retailers and specialty stores.

We use several manufacturers in the U.S. for our injection molded products that account for between 10% and 15% of our annual net sales.

Sales and Marketing

Our sales are primarily derived from the sale of juvenile health, safety and wellness products and are recognized upon transfer of title of product to our customers. Our products are marketed and sold through several distribution channels including chain retailers, specialty retailers and direct to consumers.

Sales are made utilizing standard credit terms of 30 to 60 days. We generally accept returns only for defective merchandise.

Competition

The juvenile health, safety and wellness industry has many participants, none of which have dominant market share, though certain companies have disproportionate strength in certain segments. Our largest direct competitors are Dorel Industries (Safety 1st and Cosco brands), Evenflo (Evenflo, Gerry, and Snugli brands), Kid Brands, Inc., Fisher-Price (part of Mattel, Inc.), The First Years (a subsidiary of RC2 Corporation) and Graco (a subsidiary of Newell Rubbermaid). In addition, we compete in certain of our product lines with a number of private companies, such as KidCo, Inc. and Munchkin.

The primary methods of competition in the industry consist of product innovation, brand positioning, quality, price and other factors such as timely distribution. Our competitive strengths include our experienced product development staff, our ability to develop new products, brand positioning, relationships with major retailers, and the quality and pricing of our products.

Intellectual Property

We rely on a combination of patents, licenses and trade secrets to protect our intellectual property. Our patents currently in effect include various design features related to bedrails, infant seats, bouncers, and potty chairs, with several other patents pending for monitors, baby swings, and other items. The patents expire at various times over the next 20 years. We also have license agreements relating to the use of patented technology owned by third parties in certain of our products.

Customers

Our top 10 customers in North America and the United Kingdom together comprised over 80% of our sales in fiscal 2009. Some of these customers include Babies R Us/Toys R Us, Target, K-Mart, Buy Buy Baby, and Wal-Mart in North America, and in the United Kingdom, Mothercare.

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Seasonality

There are not significant variations in seasonal demand for our products. Sales to our retail customers are generally higher in the time frame when retailers take initial shipments of new products. These orders usually incorporate enough product to fill each store plus additional amounts to be kept at the customer's distribution center. The timing of these initial shipments varies by customer depending on when they finalize store layouts for the upcoming year, and whether there are any mid-year product introductions.

Geographic Regions

In 2009, Summer Infant (USA), including international sales managed out of the U.S., accounted for approximately 90% of total Company revenue; the remaining sales were made in Canada, the United Kingdom, and all other geographies.

Regulatory Matters

We obtain all necessary regulatory agency approvals for each of our products. In the U.S., these approvals may include, among others, one or more of the Consumer Product Safety Commission ("CPSC"), the American Society of Test Methods ("ASTM"), the Juvenile Products Manufacturing Association ("JPMA"), the Federal Communications Commission ("FCC") and the Food and Drug Administration ("FDA"). We conduct our own internal testing, which utilizes a "foreseeable use and abuse" testing method and is designed to subject each product to the "worst case scenario." Our products are also frequently tested by independent government certified labs.

Insurance

We carry a product liability insurance policy that provides us with $10,000,000 of liability coverage with a minimal deductible. We consult with our insurers to ascertain appropriate liability coverage for our product mix. We anticipate increasing our insurance coverage in the future in line with our expanding sales and product breadth.

Employees

As of December 31, 2009, we employed a total of 178 people, 107 of whom work in the headquarters and distribution centers in Rhode Island. Our employees are not covered by a collective bargaining agreement. We consider our employee relations to be good.

Available Information

We maintain our corporate website at *www.summerinfant.com* and we make available, free of charge, through this website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports that we file with or furnish to the Securities and Exchange Commission ("SEC"), as soon as reasonably practicable after we electronically file that material with, or furnish it to, the SEC. Information on our website is not part of this report. This report includes all material information about us that is included on our website and is otherwise required to be included in this report.

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Item 1A. Risk Factors

If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In those cases, the trading price of our common stock could decline.

The concentration of our business with a base of retail customers that make no binding long-term commitments means that economic difficulties or changes in the purchasing policies of our major customers could have a significant impact on our business.

A number of large, retail customers account for a majority of our net sales. The customer that generated more than 10% of net sales for the year ended December 31, 2009 was Toys R Us (52% of net sales). Because of the concentration of our business with this customer and because we have no long term contracts with this customer, our success depends on our customers' willingness to purchase and provide shelf space for our products. An adverse change in our relationship with any of our large customers or a change in the financial viability of any of these customers could adversely affect our results of operations and financial condition.

Our ability to grow and compete will be harmed if we do not successfully satisfy consumer preferences, enhance existing products, develop and introduce new products, and achieve market acceptance of those products.

Our business and operating results depend largely upon the appeal of our products. Consumer preferences, particularly among parents, who are the end purchasers of our products, are constantly changing. Our success will, in large part, depend on our ability to identify emerging trends in the health, safety and wellness marketplace, and design products that address consumer demand and prove safe and cost effective. Our product offerings compete with those of many other companies, many of which are much larger and enjoy broader brand recognition and significant distribution channel relationships, which means that our market position is always at risk. Our ability to maintain and increase our current market share will depend upon our ability to anticipate changes in consumer preferences and satisfy these preferences, enhance existing products, develop and introduce new products and establish and grow distribution channels for these products, and ultimately achieve market acceptance of these products.

We are dependent on key personnel, and our ability to grow and compete in our industry will be harmed if we do not retain the continued services of our key personnel, or we fail to identify, hire, and retain additional qualified personnel.

We are dependent on the efforts of our management team, and the loss of services of members of our management team, each of whom has substantial experience in the juvenile health, safety and wellness markets, could have an adverse effect on our business. If any members of management leave, their departure could have an adverse effect on our operations and could adversely affect our ability to design new products and to maintain and grow the distribution channels for our products.

In addition, if our operations continue to grow in a manner consistent with our historical growth rates, it will be necessary for us to attract and retain additional qualified personnel. The market for qualified and talented product development personnel in the consumer goods market, and the juvenile health, safety and wellness products market specifically is intensely competitive. If we are unable to attract or retain qualified personnel as needed, the growth of our operations could be slowed or hampered. However, we believe that Summer Infant's compensation including salary, performance-based bonuses, and stock award programs provides incentives that are competitive within our industry.

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Intellectual property claims relating to our products could increase our costs and adversely affect our business.

We have, from time to time, received claims of alleged infringement of patents relating to certain of our products, and we may face similar claims in the future. These claims relate to alleged patent infringement and are primarily the result of newly issued patents that were not in force when we initially brought the subject products to market. The defense of intellectual property claims can be costly and time consuming, even in circumstances where the claim is without merit. We may be required to pay substantial damages or settlement costs in order to resolve these types of claims. In addition, these claims could materially harm our brand name, reputation and operations.

We rely on foreign suppliers in Asia to manufacture the majority of our products, and any adverse change in our relationship with our suppliers could harm our business.

We rely on numerous third-party suppliers located in Asia for the manufacture of most of our products. While we believe that alternative suppliers could be located if required, our product sourcing could be affected if any of these suppliers do not continue to manufacture our products in required quantities or at all, or with the required levels of quality. We enter into purchase orders with our foreign suppliers and do not enter into any long term contracts. In addition, difficulties encountered by these suppliers, such as fire, accident, natural disasters, outbreaks of contagious diseases, or political unrest, could halt or disrupt production at the affected locations, resulting in delay or cancellation of orders. Any of these events could result in delayed deliveries by us of our products, causing reduced sales and harm to our reputation and brand name.

Increases in the cost of materials or labor used to manufacture our products could decrease our profitability and therefore negatively impact our business and financial condition.

Because our products are manufactured by third-party suppliers, we do not directly purchase the materials used in the manufacture of our products. However, the prices paid by us to these suppliers could increase if raw materials, labor, or other costs increase. If we cannot pass these increases along to our customers, our profitability will be adversely affected.

Because we rely on foreign suppliers and we sell in to foreign markets, we are subject to numerous risks associated with international business that could increase our costs or disrupt the supply of our products, resulting in a negative impact on our business and financial condition.

Our international operations subject us to risks, including:

- economic and political instability,
- restrictive actions by foreign governments,
- greater difficulty enforcing intellectual property rights and weaker laws protecting intellectual property rights,
- changes in import duties or import or export restrictions,
- timely shipping of product and unloading of product through West Coast ports, as well as timely truck delivery to our warehouses,
- complications complying with the laws and policies of the United States affecting the importation of goods, including duties, quotas, and taxes, and
- complications in complying with trade and foreign tax laws.

Any of these events or circumstances could disrupt the supply of our products or increase our expenses.

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Product liability, product recalls, and other claims relating to the use of our products could increase our costs.

Because we sell infant and juvenile health, safety and wellness products to consumers, we face product liability risks relating to the use of our products. We also must comply with a variety of product safety and product testing regulations. If we face a product liability or other claim or fail to comply with these regulations, we may be subject to costly litigations, damage awards, fines or settlement costs that exceed our insurance coverage. We also would incur significant costs in connection with any product recall requirements. Even if a product liability or other claim is without merit, the claim could harm our reputation and divert management's attention and resources from our business.

Competition in our markets could reduce our net sales and profitability.

We operate in highly competitive markets. We compete with several large domestic and foreign companies and with other producers of infant products. Many of our competitors have longer operating histories, greater brand recognition, and greater financial, technical, marketing and other resources than we have. In addition, we may face competition from new participants in our markets because the infant product industry has limited barriers to entry. We experience price competition for our products, competition for shelf space at retailers and competition for licenses, all of which may increase in the future. If we cannot compete successfully in the future, our net sales and profitability will likely decline.

We may experience difficulties in integrating strategic acquisitions.

As part of our growth strategy, we intend to pursue acquisitions that are consistent with our mission and enable us to leverage our competitive strengths. The integration of acquired companies and their operations into our operations involves a number of risks, including:

- the acquired business may experience losses that could adversely affect our profitability;
- unanticipated costs relating to the integration of acquired businesses may increase our expenses;
- possible failure to obtain any necessary consents to the transfer of licenses or other agreements of the acquired company;
- possible failure to maintain customer, licensor and other relationships after the closing of the transaction of the acquired company;
- difficulties in achieving planned cost-savings and synergies may increase our expenses or decrease our net sales;
- diversion of management's attention could impair their ability to effectively manage our business operations; and
- unanticipated management or operational problems or liabilities may adversely affect our profitability and financial condition.

In addition, any future acquisitions or investments may result in:

- issuances of dilutive equity securities, which may be sold at a discount to market price;
- use of significant amounts of cash;

the incurrence of debt;

the assumption of significant liabilities;

unfavorable financing terms;

large one-time expenses; and

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- the creation of intangible assets, including goodwill, the write-down of which may result in significant charges to earnings.

Our debt covenants may limit our ability to complete acquisitions, incur debt, make investments, sell assets, merge or complete other significant transactions.

Our loan agreements include provisions that place limitations on a number of our activities, including our ability to:

- incur additional debt;
- create liens on our assets or make guarantees;
- make certain investments or loans;
- pay dividends; or
- dispose of or sell assets or enter into a merger or similar transaction.

We could issue additional common stock, which might dilute the book value of our common stock.

Our board of directors has authority, without action or vote of our stockholders in most cases, to issue all or a part of our authorized but unissued shares. These stock issuances could be made at a price that reflects a discount from the then-current trading price of our common stock. In addition, to raise capital, we may need to issue securities that are convertible into or exchangeable for a significant amount of our common stock. These issuances would dilute current shareholders' ownership percentage which would have the effect of reducing their influence on matters on which stockholders vote, and could dilute the book value of Summer Infant common stock. Stockholders may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise their options, or if warrant holders exercise their warrants to purchase shares of Summer Infant common stock.

As a "thinly-traded" stock, large sales can place downward pressure on our stock price.

Our common stock experiences periods when it could be considered "thinly traded." Finance transactions resulting in a large amount of newly issued shares that become readily tradable, or other events that cause current stockholders to sell shares, could place downward pressure on the trading price of our stock. In addition, the lack of a robust resale market may require a stockholder to sell a large number of shares in increments over time to mitigate any adverse impact of the sales on the market price of our stock.

Anti-takeover provisions in our organizational documents and Delaware law may limit the ability of our stockholders to control our policies and effect a change of control of our company and may prevent attempts by our stockholders to replace or remove our current management, which may not be in your best interests.

There are provisions in our certificate of incorporation and bylaws that may discourage a third party from making a proposal to acquire us, even if some of our stockholders might consider the proposal to be in their best interests, and may prevent attempts by our stockholders to replace or remove our current management. These provisions include the following:

- our certificate of incorporation provides for three classes of directors with the term of office of one class expiring each year, commonly referred to as a staggered board. By preventing stockholders from voting on the election of more than one class of directors at any annual meeting of stockholders, this provision may have the effect of keeping the current members of our board of directors in control for a longer period of time than stockholders may desire;

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- our certificate of incorporation authorizes our board of directors to issue shares of preferred stock without stockholder approval and to establish the preferences and rights of any preferred stock issued, which would allow the board to issue one or more classes or series of preferred stock that could discourage or delay a tender offer or change in control; and

- our bylaws require advance written notice of stockholder proposals and director nominations.

Additionally, we are subject to Section 203 of the Delaware General Corporation Law, which, in general, imposes restrictions upon acquirers of 15% or more of our stock. Finally, the board of directors may in the future adopt other protective measures, such as a stockholder rights plan, which could delay, deter or prevent a change of control.

The global economic downturn could result in a reduced demand for our products and increased volatility in our stock price.

Current uncertainty in global economic conditions pose a risk to the overall economy as consumers and retailers may defer or choose not to make purchases in response to tighter credit and negative financial news, which could negatively affect demand for our products. Additionally, due to the weak economic conditions and tightened credit environment, some of our retailers and distributors may not have the same purchasing power, leading to lower purchases of our products for placement into distribution channels. Consequently, demand for our products could be materially different from expectations, which could negatively affect our profitability and cause our stock price to decline.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We are headquartered in a 52,000 square facility in Woonsocket, Rhode Island. We have a seven year lease on this facility, with an option to extend for an additional five years.

We have a 36 month, 3,750 square foot lease for office space in South Carolina, which expires in 2012. We have a 24 month lease for office space in Hong Kong, which expires in 2011, as well as a 60 month lease for office space in the United Kingdom, which expires in 2012.

We maintain inventory at leased warehouses in California (approximately 220,000 square feet, which includes two warehouses), Rhode Island (approximately 104,000 square feet), Canada (approximately 31,000 square feet), and the UK (approximately 16,000 square feet). These leases expire at various times between 2010 and 2013.

Item 3. Legal Proceedings

None.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of our stockholders during the fourth quarter of the year ended December 31, 2009.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Price Range of Common Stock

On March 7, 2007, our common stock, warrants and units commenced listing on the Nasdaq Capital Market under the symbols "SUMR", "SUMRW" and "SUMRU", respectively.

On March 17, 2008, we announced that effective March 28, 2008, the units will be separated into its component securities, consisting of one share of common stock and two warrants. As a result, beginning on March 28, 2008, the units ceased trading. The warrants expired on April 20, 2009.

The high and low closing prices for our common stock as reported on the Nasdaq Capital Market for the periods indicated below were as follows:

	High	Low
Fiscal Year Ended December 31, 2008		
First Quarter	$ 4.90	$ 3.67
Second Quarter	$ 4.80	$ 3.84
Third Quarter	$ 4.79	$ 3.76
Fourth Quarter	$ 4.50	$ 2.10
Fiscal Year Ended December 31, 2009		
First Quarter	$ 2.36	$ 1.16
Second Quarter	$ 2.82	$ 1.55
Third Quarter	$ 5.00	$ 2.01
Fourth Quarter	$ 5.25	$ 4.14

Holders of Common Stock

As of January 25, 2010, there were approximately thirteen shareholders of record of our common stock. Because shares of our common stock are held by depositaries, brokers and other nominees, the number of beneficial holders of our shares is substantially larger than the number of record holders.

Dividend Policy

There have been no cash dividends declared on our common stock since our company was formed. Dividends are declared at the sole discretion of our Board of Directors. Our intention is not to declare cash dividends and retain all cash for our operations.

Issuer Repurchases of Equity Securities

On October 9, 2007, we made a tender offer to all holders of our warrants to repurchase each warrant for $1.00. The tender offer expired on November 8, 2007. The total number of warrants purchased in the tender offer was 14,766,047. All of the warrants which remained after the tender offer expired on April 20, 2009.

Unregistered Sales of Equity Securities

In connection with the acquisition of the assets of Butterfly Living, LLC ("Butterfly") on July 17, 2009, the Company issued to Butterfly 213,675 shares (the "Butterfly Shares") of the Company's common stock, par value $0.001 per share in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"). The Butterfly Shares were issued at fair market value in partial consideration for the purchase by the Company of substantially all of the assets of Butterfly. The offer and sale of these shares of common stock was made to "accredited investors," as defined in Rule 501 under the Securities Act, in reliance on the exemption from registration provided by Section 4(2) of the Securities Act.

Item 6. Selected Consolidated Financial Data

N/A

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollar amounts in thousands, except share and per share data)

The information contained in this section has been derived from our consolidated financial statements and should be read together with our consolidated financial statements and related notes included elsewhere in this filing.

The following discussion is intended to assist in the assessment of significant changes and trends related to our results of operations and financial condition. This discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto included herein. Our business has grown organically in all of our markets. We derive our revenues from the sale of health, safety and wellness products for infants and toddlers. Our revenue is driven by our ability to design and market desirable products, identify business opportunities and secure new and renew existing distribution channels. Our income from operations is derived from our ability to generate revenue and collect cash in excess of labor and other costs of providing our products and selling, general and administrative costs.

Company Overview

We are a designer, marketer, and distributor of branded juvenile health, safety and wellness products which are sold principally to large North American and United Kingdom retailers. We currently have more than 80 proprietary products in various product categories including nursery audio/video monitors, safety gates, durable bath products, bed rails, infant thermometers, related health and safety products, booster and potty seats, cribs, baby gear, bouncers and soft goods/bedding.

Our strategy is to grow our sales through a variety of methods, including:

- increased product penetration (more products at each store);
- increased store penetration (more stores within each retail customer);
- new products (at existing and new customers);
- new retail customers;
- acquisitions;
- new geographies (international expansion); and
- new product categories.

We have has been able to grow our annual revenues historically through a combination of all of the above factors. Each year, we have been able to expand the number of products in our main distribution channel, mass merchant retailers, and have also added new customers each year. Therefore, even without new product introductions, we could grow our business by simply selling more of our existing product line to existing customers.

In the future, our growth strategy will be to continue to develop and sell new products to our existing customer base, sell new and existing products to new customers (or expand relationships with existing customers), expand our sales of products from our soft goods product line, and expand in the United Kingdom and in other geographic regions (including Japan, Mexico and Australia, among others). In addition, there are a number of potential acquisition candidates that could be pursued in order to obtain new innovative products, new product categories, new retail customers or new sales territories. There are approximately 400 active juvenile product companies, of which approximately 300 have less than $10 million in sales. In addition, there are various product categories that we do not currently compete in, including car seats, strollers, walkers, and other categories. We may look to

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develop our own products in these categories or attempt to gain entrance into these categories through acquisitions.

As we continue to grow through internal initiatives and any future acquisitions, we will incur additional expenses. Two of the key areas in which those increased expenses will likely occur are sales and product development. To grow sales, we will likely hire additional sales personnel to service new geographic territories, focus existing resources on specific parts of the United States market and retain product line specialists to drive sales of new and existing products in specific areas in which we believe we can readily increase sales. Product development expenses will increase as we develop new products in existing and new categories.

If we were to acquire one or more companies as part of our growth strategy, we would face various challenges such as the integration of the acquired companies' product lines, employees, marketing requirements and information systems. Ongoing infrastructure investment also may be required to support realized growth, including expenditures with respect to upgraded and expanded information systems and enhancing our management team.

Sales

Our revenues are primarily derived from the sale of juvenile health, safety and wellness products and are recognized upon transfer of title of product to our customers. Our products are marketed through several distribution channels including chain retailers, specialty retailers and direct to consumers.

A number of large, retail customers account a majority of our net sales. The customer that generated more than 10% of net sales for the year ended December 31, 2009 was Toys R Us (52% of such net sales). Because of the concentration of our business with this customer and because we have no long term contracts with this customer, our success depends on our customers' willingness to purchase and provide shelf space for our products.

Over 90% of sales are currently made to customers in North America, with the remaining sales primarily made to customers in the United Kingdom. Sales are made utilizing standard credit terms of 30 to 60 days. We generally accept returns only for defective merchandise.

Cost of goods sold and other expenses

Our products are manufactured by third parties, with approximately 85-90% of the dollar value of products being manufactured in Asia and the majority of the balance being manufactured in the U.S. Cost of goods sold primarily represents purchases of finished products from these third party manufacturers. The remainder of our cost of goods sold includes duties on certain imported items, freight-in from suppliers and miscellaneous charges from contract manufacturers. Substantially all of our purchases are made in US dollars; therefore, most of this activity is not subject to currency fluctuations. If our suppliers experience increased raw materials, labor or other costs and pass along those cost increases through higher prices for finished goods, our cost of sales would increase, and to the extent we are unable to pass these price increases along to our customers, our gross margins would decrease.

Selling, general and administrative expenses primarily consist of payroll, insurance, professional fees, royalties, freight out to customers, product development costs, advertising and marketing expenses (including co-op advertising allowances as negotiated with certain customers) and sales commissions. Several of these items fluctuate with sales; some are based on sales to particular customers and others are based on sales of particular products.

There are not significant variations in seasonal demand for our products. Sales to our retail customers are generally higher in the time frame when retailers take initial shipments of new products.

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These orders usually incorporate enough product to fill each store plus additional amounts to be kept at the customer's distribution center. The timing of these initial shipments varies by customer depending on when they finalize store layouts for the upcoming year, and whether there are any mid-year product introductions.

Summary of critical accounting policies and estimates

This summary of our critical accounting policies is presented to assist in understanding our consolidated financial statements. The consolidated financial statements and notes are representations of our management, which is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the consolidated financial statements.

We make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses. The accounting policies described below are those we consider critical in preparing our financial statements. Some of these policies include significant estimates made by management using information available at the time the estimates were made. However, these estimates could change materially if different information or assumptions were used.

Revenue recognition

We record revenue when all of the following occur: persuasive evidence of an arrangement exists, product delivery has occurred, the sales price to the customer is fixed or determinable and collectability is reasonably assured. Sales are recorded net of provisions for returns and allowances, product placement fees, cash discounts and markdowns. We base our estimates for discounts, returns and allowances on negotiated customer terms and historical experience. These estimates are subject to variability, as actual deductions taken by customers may be different from the estimates recorded.

Sales incentives or other consideration given by us to customers that are considered adjustments of the selling price of its products, such as allowances and product placement fees, are reflected as reductions of revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer's national circular ad, are reflected as selling and marketing expenses in the accompanying statements of income.

Trade receivables

We carry our trade receivables at net realizable value. On a periodic basis, we evaluate our trade receivables and establish an allowance for doubtful accounts based on a history of past bad debt expense, collections and current credit conditions. The allowance is adjusted based on actual write-offs that occur. We have a credit insurance policy to protect against potential losses up to stated amounts from certain customers.

We do not accrue interest on trade receivables. A receivable is considered past due if payments have not been received within the credit terms on the account, typically 60 days for most customers.

We will turn an account over for collection around 120 days past due. Accounts are considered uncollectible if no payments are received 60 to 90 days after they have been turned over for collection.

Inventory Valuation

Inventory is comprised of finished goods and is stated at the lower of cost, inclusive of freight and duty, or market (net realizable value) using the first-in, first-out (FIFO) method. Our warehousing costs are charged to expense as incurred. Inventory write-downs are recorded for damaged, obsolete or slow-moving inventory. Management uses estimates to record write-downs based on its review of

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inventory by product category, including length of time on hand and estimates of future orders for each product. Changes in consumer preferences, as well as demand for products, customer buying patterns and inventory management could impact the inventory valuation.

Impairment of long-lived assets, goodwill and other intangible assets.

Long-lived assets have been reviewed for impairment based on accounting guidance which requires that an impairment loss be recognized whenever the carrying value of an asset exceeds the sum of the undiscounted cash flows expected to result from the use and eventful disposition of that asset, excluding future interest costs the entity would recognize as an expense when incurred. Goodwill and other intangible assets that have indefinite useful lives are not amortized, but rather tested at least annually for impairment. Our management reviews for indicators that might suggest an impairment loss could exist. Testing for impairment requires estimates of expected cash flows to be generated from the use of the assets. Various uncertainties, including changes in consumer preference, deterioration in the political environment, continued adverse conditions in the capital markets or changes in general economic conditions, could impact the expected cash flows to be generated by an asset or group of assets. Intangible assets that have finite useful lives are amortized over their useful lives.

Allowance for doubtful accounts.

The allowance for doubtful accounts represents adjustments to customer trade accounts receivable for amounts deemed uncollectible. The allowance for doubtful accounts reduces gross trade receivables to their estimated net realizable value. The allowance is based on our assessment of the business environment, customers' financial condition, historical trends, customer payment practices, receivable aging and customer disputes. We will continue to proactively review its credit risks and adjust its customer terms to reflect the current environment.

Income taxes

Effective January 1, 2007, we adopted the provisions of new accounting guidance which provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements. Tax positions must meet a "more-likely-than-not" recognition threshold at the effective date to be recognized upon adoption and in subsequent periods. Upon adoption, we had no unrecognized tax benefits.

Deferred income tax assets are adjusted by a valuation allowance, if necessary, to recognize future tax benefits only to the extent, based on available evidence; it is "more-likely-than-not" such benefits will be realized. We recognize interest and penalties, if any, related to uncertain tax positions in selling, general and administrative expenses.

The tax years 2005 through 2008 remain open to examination by the major taxing jurisdictions in which we operate. We expect no material changes to unrecognized tax positions within the next twelve months.

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Results of Operations

Summer Infant, Inc. and Subsidiaries
Consolidated Statements of Income
For the Years Ended December 31, 2009 and 2008

The numbers in the table below are in thousands of U.S. dollars; the text below the table is in whole numbers.

	Year ended December 31, 2009		Year Ended December 31, 2008	
Net sales	$ 153,481	100.0%	$ 132,369	100.0%
Cost of goods sold	98,233	64.0%	85,514	64.6%

Depreciation and Amortization

Information Technology
$28 $14 $57 $73
Industrial Products
111 103 343 291

Consolidated segments
139 117 400 364
Corporate
4 7 14 20

Consolidated depreciation and amortization
$143 $124 $414 $384

Capital Expenditures

Information Technology
$18 $(32) $65 $(68)
Industrial Products
28 9 41 194

Consolidated segments
46 (23) 106 126
Corporate
1 1 6 10

Consolidated capital expenditures
$47 $(22) $112 $136

(unaudited, in thousands)		**September 30, 2009**		**December 31, 2008**
Identifiable Assets				
Information Technology	$	2,864	$	2,600
Industrial Products		3,846		4,415
Consolidated segments		6,710		7,015
Corporate		3,953		1,691
Consolidated assets	$	10,663	$	8,706

12. *Fair Value of Financial Instruments* The carrying value of cash, accounts receivable, accounts payable and certain other financial instruments (such as short-term borrowings, accrued expenses, and other current liabilities) included in the accompanying consolidated balance sheets approximates their fair value principally due to the short-term maturity of these instruments. The carrying value of non-interest bearing notes receivables beyond one year have been discounted at a rate of 6% which approximates rates currently offered in the market for notes receivable with similar terms and conditions. The fair value of equity method and cost method investments has not been determined as it was impracticable to do so.

    Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and trade accounts and notes receivable. Our available cash and cash equivalents are held in accounts managed by third-party financial institutions and consists of cash in our operating accounts and invested cash. The invested cash is invested in interest-bearing funds managed by third-party financial institutions. These funds generally invest in direct obligations of the government of the United States. Cash held in operating accounts may exceed the Federal Deposit Insurance Corporation, or FDIC, insurance limits. While we monitor cash and cash equivalents balances in our operating accounts on a regular basis and adjust the balances as appropriate, these balances could be impacted if the underlying financial institutions fail. To date, we have experienced no loss or lack of access to our cash or cash equivalents; however, we can provide no assurances that access to our cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

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13. *Stockholder Rights Offering* On July 17, 2009, we completed a rights offering of common stock to our shareholders. Under the terms of the rights offering, we distributed at no charge to the holders of our common stock non-transferable rights to purchase shares of our common stock. We distributed one right for each share of common stock owned by such holder on the record date of June 17, 2009. Each right entitled the holder to purchase one share of our common stock at a subscription price of $.70 per share. Stockholders on the record date were also entitled to subscribe, subject to allotment among all subscribing stockholders, for additional shares not subscribed for by other stockholders. A registration statement relating to the rights offering filed with the Securities and Exchange Commission was declared effective on June 18, 2009. The rights offering commenced on June 18, 2009 and terminated on July 17, 2009. The company sold 4,479,014 new shares of common stock and received gross proceeds of $3,135,310, less expenses related to the transaction of $149,000, from the rights offering. Giving effect to the rights offering, we have 8,958,028 shares of common stock outstanding as of September 30, 2009. Subsequent to the completion of the rights offering, we paid down our working capital line of credit in full and expect to use remaining proceeds from the rights offering primarily to support plans for our CoreCard subsidiary as well as other general working capital purposes.
14. *Subsequent Events* We evaluated subsequent events through November 11, 2009 when these financial statements were issued. We are not aware of any significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on our Consolidated Financial Statements.
15. *New Accounting Pronouncements* In October 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-13, Multiple-Deliverable Revenue Arrangements, which amends Accounting Standards Codification (ASC) Topic 605, Revenue Recognition. ASU 2009-13 amends the ASC to eliminate the residual method of allocation for multiple-deliverable revenue arrangements, and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The ASU also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence if available, (2) third-party evidence if vendor-specific evidence is not available, and (3) estimated selling price if neither vendor-specific nor third-party evidence is available. Additionally, ASU 2009-13 expands the disclosure requirements related to a vendor s multiple-deliverable revenue arrangements. The changes to the ASC as a result of this update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 (January 1, 2011 for us), and we are currently evaluating the potential impact, if any, of the adoption on our Consolidated Financial Statements.

    In May 2009, the FASB issued authoritative guidance establishing general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. This guidance, which was incorporated into ASC Topic 855, Subsequent Events, was effective for interim or annual financial periods ending after June 15, 2009, and the adoption did not have any impact on our Consolidated Financial Statements.

    In December 2007, the FASB issued authoritative guidance establishing accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent. Specifically, this guidance requires the presentation of noncontrolling interests as equity in the Consolidated Balance Sheets, and separate identification and presentation in the Consolidated Statement of Operations of net income attributable to the entity and the noncontrolling interest. This guidance, which was incorporated into ASC Topic 810, Consolidation, was adopted by us as of January 1, 2009, and, as required, was applied to the prior period s financial statements. This guidance also established accounting and reporting standards regarding deconsolidation and changes in a parent s ownership interest, which will be applied prospectively to any such transactions in 2009 onward. As a result of the adoption, we reclassified a non-controlling interest totaling $1,516,000, which had previously been recorded in the liability section of the consolidated balance sheets, as a component of stockholders equity for all periods presented.

    In December 2007, the FASB issued revised authoritative guidance related to business combinations, which provides for recognition and measurement of identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in the acquiree at fair value. The guidance also established disclosure requirements to enable the evaluation of the nature and financial effects of a business combination. We adopted this guidance, which was incorporated into ASC Topic 805, Business Combinations, as of January 1, 2009, and the adoption did not have a material impact on our Consolidated Financial Statements.

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

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

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

For purposes of this discussion and analysis, we are assuming and relying upon the reader s familiarity with the information contained in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, in the Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission.

Overview

Our consolidated subsidiaries operate in two industry segments: Information Technology Products and Services (Information Technology) and Industrial Products. The Industrial Products segment consists of ChemFree Corporation (ChemFree) (bio-remediating parts washers). The Information Technology sector consists of CoreCard Software, Inc. (CoreCard) (software for managing accounts receivables, credit and prepaid cards). As discussed in Note 4 to the Consolidated Financial Statements, we sold our VISaer business as of April 16, 2008. Accordingly, the Consolidated Financial Statements reported in this Form 10-Q and the discussion below do not include the results of our VISaer subsidiary as part of continuing operations.

We derive our product revenue from sales of software licenses in our Information Technology sector and sales and leases of equipment and supplies in our Industrial Products sector. Our service revenue consists of fees for implementation, consulting, training, maintenance and support for software products in our Information Technology sector. Our consolidated revenue is the aggregate of the revenue generated at our subsidiary companies. Our revenue fluctuates from period to period and our results are not necessarily indicative of the results to be expected in future periods. Period-to-period comparisons may not be meaningful and it is difficult to predict the level of consolidated revenue on a quarterly or annual basis for a number of reasons, including the following:

- A change in revenue level at one of our subsidiaries may impact consolidated revenue or be offset by an opposing change at another subsidiary.

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

- In a given period, new license revenue related to our Information Technology sector may consist of a relatively small number of new contracts. Consequently, even small delays in a delivery under a new software contract (which may be out of our control) could have a significant and unpredictable impact on consolidated revenue that we recognize in a given quarterly or annual period.

Frequently we incur consolidated operating losses on a quarterly and annual basis and are likely to do so in the future from time to time. Our operating expenses consist of the aggregate of our subsidiaries expenses and the corporate office expenses. Our ChemFree subsidiary generates an operating profit on a regular basis but our earlier stage subsidiary, CoreCard, is not consistently profitable, mainly due to significant research and development expense that is invested to complete new product offerings and the deferral of revenue recognition until such products are delivered to and accepted by customers. Depending upon the size and number of software licenses recognized in a particular period and the level of expenses incurred to support development and sales activities, CoreCard may report operating profits on an irregular basis as it builds its customer base. A significant portion of our subsidiaries expense is related to personnel. For these and other reasons, our operating profits or losses may vary from quarter to quarter and at the present time are generally not predictable with any degree of certainty.

From time to time, we also generate income or incur losses from non-operating sources and we may do so in the future. We may derive income from sales of holdings in subsidiary, affiliate and other minority-owned companies, as exemplified in the VISaer sale, discussed in more detail in Note 4 to the Consolidated Financial Statements. Occasionally, we record a charge if we believe the value of a non-consolidated company is impaired. We also recognize on a quarterly basis our pro rata share of the income or losses of a minority-owned affiliate company 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, either on a quarterly or annual basis.

Results of Operations

The following discussion should be read in conjunction with the Consolidated Financial Statements and the notes to Consolidated Financial Statements presented in this quarterly report.

Revenue Total revenue from continuing operations in the three month period ended September 30, 2009 was $3.4 million, equal to the revenue reported in the third quarter of 2008, but an increase of 23 percent and 9 percent compared to the first and second quarters of 2009, respectively. For the nine month period ended September 30, 2009, total revenue was $9.3 million, a decline of 21 percent compared to the same period in 2008.

Revenue from products, which includes sales and leases of equipment and supplies in our Industrial Products segment as well as software license fees related to the Information Technology segment, was $3.1 million in both three month periods ended September 30, 2009 and 2008. In the year-to-date period of 2009, product revenue declined by 26 percent compared to the first nine months of 2008. The 2009 year-to-date decline is primarily due to the fact that in the first half of 2008, one of ChemFree s largest customers was in the middle of a national program to sell ChemFree products resulting in a high initial volume of sales. With the initial rollout complete, as anticipated the number of new machines sold to this customer in the first half of 2009 was lower than during the rollout period last year. During the first two quarters of 2009, there was also a period-to-period decline in equipment sales in the international market reflecting the general economic slowdown in certain European markets. However, in the third quarter of 2009, sales of new SmartWasher® machines in both the domestic and international markets were stronger than in the first two quarters of 2009. Worldwide sales of ChemFree s fluid and filter consumables in the three and nine month periods ended September 30, 2009 increased compared to the same periods in 2008, reflecting an increasing base of users of its SmartWasher® part washers. However, sales of fluid to the European market were lower in the year-to-date 2009 period compared to the nine month period of 2008 due to a transition to a new fluid blending facility in the UK. In order to reduce shipping costs and improve supply to its European market, effective in the third quarter of 2009, ChemFree earns a fee based on fluid blended in the UK that is equal to the gross margin ChemFree historically earned on fluid shipments from the US to its UK distributor. As a result, gross revenue reported on fluid for the European markets is lower in 2009 (and will be going forward as well) but the gross profit to ChemFree is comparable under this new arrangement to what it would have earned shipping bulky fluid containers overseas.

Software license revenue associated with the Information Technology segment increased in both the three and nine month periods ended September 30, 2009 compared to the respective periods in 2008 due to more new license contracts. The company recognizes software license revenue generally upon completion of each contract and acceptance by customers.

Service revenue associated with the Information Technology segment was $268,000 and $1,112,000 in the three and nine months ended September 30, 2009, representing a decline of 12 percent and an increase of 57 percent compared to the respective periods in 2008. Year-to-date, the growth in service revenue is attributed to increased professional services projects that were completed for CoreCard customers as well as an increase in the installed base of customers that pay for maintenance and technical support. On a quarterly basis, revenue from customer projects will vary depending on customer requirements and timetables, whereas maintenance revenue is fairly consistent.

Due to general economic conditions and uncertainty about the impact of a slow economy on the automotive repair and supplies industry, ChemFree had anticipated a relatively flat volume of machine sales for 2009 and carefully managed its costs and inventory levels accordingly. Sales of replenishment fluid and filter to the installed base of customers and lease revenue have been relatively unaffected by fluctuations in general economic conditions. Turmoil in the global financial markets could impact CoreCard s revenue and prospects in the foreseeable future if customers or prospects postpone software purchases or implementations. We are carefully monitoring the evolving dynamics in the marketplace and proactively lowered expenses going into 2009. We expect to fully support existing customers and contracts and have added new prospects and customers in 2009. We expect to use the funds received from the successful completion of our stockholder rights offering as described in more detail in Note 13 to the Consolidated Financial Statements to support CoreCard s growth plans, as well as other general corporate purposes.

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Cost of Revenue Total cost of revenue was 53 percent and 54 percent of total revenue in the three and nine month periods ended September 30, 2009, respectively, compared to 58 percent and 60 percent of total revenue in the three and nine month periods ended September 30, 2008, respectively. The improvement in 2009 is related mainly to favorable changes in ChemFree s product mix in both the three and nine month periods in 2009.

Cost of product revenue was 51 percent and 52 percent of product revenue in the three and nine months ended September 30, 2009, respectively compared to costs of 58 percent of product revenue in the three and nine month periods in 2008. Revenue from higher margin fluid and filters and software licenses was a larger percentage of product revenue in 2009 than in the comparable periods in 2008, resulting in the improved gross margin.

Cost of service revenue (which relates to our CoreCard business only) was significantly lower as a percent of service revenue in the nine month period ended September 30, 2009 as compared to the same period last year. The mix of service revenue in a given period, as well as the number of customers and new products being supported, impacts the gross margin on service revenue. The year-to-date improvement in gross margin in 2009 is due in part to a higher volume of professional service revenue which has a relatively lower cost to deliver than does our customer support and maintenance revenue (both of which are included in the category of service revenue). CoreCard is providing a high level of support to its initial customers to ensure it builds a solid base of reference customers and puts in place an infrastructure for future growth. Cost of providing routine maintenance and support services as a percentage of service revenue is expected to decrease as CoreCard s installed base of customers increases, whereas the cost of professional services is expected to have a relatively consistent gross margin percentage from period to period for similar types of projects.

Operating Expenses In the three and nine month periods ended September 30, 2009, total consolidated operating expenses were lower by 12 percent and 30 percent, respectively, than in the corresponding periods in 2008. At the beginning of 2009, we implemented company-wide headcount reductions and pay cuts. These actions and the associated reductions in personnel-related and travel expenses resulted in substantial cost savings in the three and nine month periods of 2009 as compared to the respective periods in 2008. Consolidated marketing expenses declined by 10 percent and 33 percent in the three and nine month periods in 2009 compared to the same periods in 2008 mainly due to lower sales commissions paid by ChemFree and a reduction in personnel and travel related expenses. Consolidated general and administrative expenses were 7 percent higher in the three month period ended September 30, 2009 but 22 percent lower in the nine month period ended September 30, 2009, respectively, compared to the same periods in 2008. The changes reflect lower personnel-related expenses in both periods in 2009 and lower legal expenses for the year-to-date period in 2009 compared to year-to-date in 2008. However, legal expenses in the third quarter of 2009 were significantly higher than in the third quarter of 2008, reflecting the trial that took place in July 2009 related to ChemFree s legal action, as explained in more detail in Note 9 to the Consolidated Financial Statements. Consolidated research and development expenses were 31 percent and 38 percent lower in the three and nine month periods in 2009, respectively, compared to the same periods in 2008, mainly due to a reduction in consulting fees and personnel-related expenses associated with our CoreCard business. In August 2009, the company increased the base salary levels for most of its personnel back to the level that had been in place before the company-wide pay cuts were implemented at the beginning of the year.

Interest Income (Expense), net We recorded net interest income of $26,000 and $57,000 in the three and nine month periods in 2009 compared to net interest income of $5,000 and interest expense of $4,000 in the three and nine month periods ended June 30, 2008. The difference between periods reflects primarily the net effect of periodic fluctuations in our bank borrowings and notes receivable balances.

Equity in Income of Affiliate Company On a quarterly basis, we recognize our pro rata share of the earnings or losses of our affiliate company that we record on the equity method. We recorded $4,000 and $24,000 in net equity income of our affiliate company in the three and nine months ended September 30, 2009, respectively. These amounts are lower as compared to the respective periods in 2008, reflecting a decline in profitability of the affiliate company.

Other Income We recorded $6,000 and $18,000 of other miscellaneous income items in the three and nine-month periods ended September 30, 2009.

Income Taxes We recorded $6,000 and $10,000 in the three and nine month periods ended September 30, 2009 for state income tax expense. We believe our net deferred tax assets should be fully reserved at September 30, 2009 given their character and our historical losses. Accordingly, no deferred tax assets have been recorded at September 30, 2009.

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Discontinued Operations

Income (Loss) from Discontinued Operations The amounts recorded in 2008 reflect the operations of our VISaer subsidiary which have been classified as a discontinued operation as a result of the sale of the VISaer business as explained in Note 4 to the Consolidated Financial Statements.

Liquidity and Capital Resources

On July 17, 2009, we completed a rights offering of common stock to our shareholders. The company sold 4,479,014 new shares of common stock and received gross proceeds from the rights offering of $3.1 million, less expenses related to the transaction of $149,000. Subsequent to the completion of the rights offering, we paid down our working capital line of credit in full and expect to use remaining proceeds from the rights offering primarily to support plans for our CoreCard subsidiary as well as other general working capital purposes.

Our cash balance at September 30, 2009 was $3.3 million compared to a cash balance of $1.0 million at December 31, 2008. During the nine months ended September 30, 2009, our principal sources of cash were net proceeds of $3.0 million from the shareholder rights offering completed on July 19, 2009, borrowings of $335,000 on our line of credit and $352,000 from payments received on notes receivable. Other working capital sources of cash include a reduction in inventory levels of $247,000, an increase in deferred revenue of $513,000 and an increase of $209,000 in accounts payable. During the nine month period, we used $645,000 in net cash for operations, principally to support CoreCard and its international software development and testing operations and our corporate office, and paid down $660,000 on our bank line of credit. Working capital uses of cash included an increase in accounts receivable of $435,000, reflecting increased billings.

As explained in Note 8 to the Consolidated Financial Statements, in June 2009 we renewed our bank line of credit for an additional one-year term, expiring June 30, 2010. The line, which we use from time to time to support short-term cash needs, has a maximum availability of $1.25 million based on qualifying accounts receivable and inventory levels. We presently project that we will have sufficient accounts receivable, inventory balances and tangible net worth for the foreseeable future to support the line of credit borrowing base for any required draws under our bank line of credit, although we presently anticipate limited, if any, borrowings in the foreseeable future, given the recent proceeds from the rights offering. However, if we fail to control costs, if we fail to meet software delivery commitments, if anticipated customer payments are delayed for any reason or if we encounter unforeseen delays in product development or production, we could require more cash than presently planned.

Long-term, we currently expect that liquidity will continue to improve and consolidated operations will generate sufficient cash to fund their requirements with use of our credit facility if necessary to accommodate short-term needs. Other long-term sources of liquidity include potential sales of investments or subsidiaries although the timing and amount of any such transactions are uncertain and, to the extent they involve non-consolidated companies, generally not within our control.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements that are reasonably likely to have a current or future material effect on our financial condition, liquidity or results of operations.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We consider certain accounting policies related to revenue recognition, valuation of acquired intangibles and impairment of long-lived assets, and valuation of investments to be critical policies due to the estimation processes involved in each. Management discusses its estimates and judgments with the Audit Committee of the Board of Directors. For a detailed description on the application of these and other accounting policies, see Note 1 to the Consolidated Financial Statements contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Reference is also made to the discussion of the application of these critical accounting policies and estimates contained in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for 2008. Except as explained in Note 3 to the Consolidated Financial Statements, during the three and nine month periods ended

September 30, 2009, there were no significant or material changes in the application of critical accounting policies that would require an update to the information provided in the Form 10-K for 2008.

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 future results of operations or projected cash requirements. It is difficult to predict future quarterly and annual results with certainty. Any trend or delay that affects one of our subsidiaries could have a negative impact on the company s consolidated results of operations or cash requirements on a quarterly or annual basis. In addition, the carrying value of our investments is impacted by a number of factors which are generally beyond our control since we are typically a non-controlling shareholder in a private company with limited liquidity.

Among the numerous factors that may affect our consolidated results of operations or financial condition are the following:

Turmoil in the global financial markets could have a serious negative impact on CoreCard due to potential customers (most of whom are financial institutions or services firms) delaying purchase or implementation decisions.

Reluctance by financial institutions to act as sponsor banks for prospective customers (such as issuers and processors of credit and prepaid cards) could increase CoreCard s losses and cash requirements.

It is unclear to what extent the general weakness in the domestic US and European economies will impact the automotive parts and repair industry and reduce future demand for ChemFree s SmartWasher® products.

Delays in software development projects could cause our customers to delay implementations or delay payments, which would increase our costs and reduce our revenue.

Our CoreCard subsidiary could fail to deliver software products which meet the business and technology requirements of its target markets within a reasonable time frame and at a price point that supports a profitable, sustainable business model.

One of ChemFree s customers represented 37 percent of our consolidated revenue in the first nine months of 2009 and any unplanned changes in the volume of orders or timeliness of payments from such customer could have a negative impact on revenue, profits, inventory levels and cash, at least in the near-term.

Failure by ChemFree to protect its intellectual property assets could increase competition in the marketplace and result in greater price pressure and lower margins, thus potentially impacting sales, profits and projected cash flows.

Software errors or poor quality control may delay product releases, increase our costs, result in non-acceptance of our software by customers or delay revenue recognition.

Compliance with the internal control over financial reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002 will increase expenses and divert management and staff resources.

Competitive pressures (including pricing, changes in customer requirements and preferences, and competitor product offerings) may cause prospective customers to choose an alternative product solution, resulting in lower revenue and profits (or increased losses).

CoreCard could fail to expand its base of customers, resulting in lower revenue and profits (or increased losses), increased cash needs and possibly leading to restructuring or cutting back of the subsidiary s operations.

In certain limited situations, ChemFree lease customers are permitted to terminate the lease covering a SmartWasher® machine, requiring the unamortized balance of the original machine cost to be written off which could reduce profits in that reporting period and result in lower revenue in future periods.

CoreCard could fail to retain key software developers and managers who have accumulated years of know-how in our target markets and company products, or fail to attract and train a sufficient number of new software developers and testers to support our product development plans and customer requirements at projected cost levels.

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

Declines in performance, financial condition or valuation of minority-owned companies could cause us to write-down the carrying value of our investment or postpone an anticipated liquidity event, which could negatively impact our earnings and cash flow.

Failure to regain compliance with the continued listing standards of NYSE Amex could result in delisting of our common stock, with a potentially negative impact on market price and liquidity of our common stock.

Other general economic and political conditions could cause customers to delay or cancel software purchases.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the company carried out an evaluation, under the supervision and with the participation of the company s management, including the company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the company s disclosure controls and procedures pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the company s disclosure controls and procedures are effective. There were no significant changes in the company s internal control over financial reporting or in other factors identified in connection with this evaluation that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the company s internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as described in Note 9 to the Consolidated Financial Statements, we are not currently subject to any material legal proceedings. However, from time to time, we may become a party to certain legal proceedings in the ordinary course of business. As of September 30, 2009, we do not believe any ongoing legal proceedings will have a material adverse effect on our consolidated financial position or results of operations.

Item 6. Exhibits

The following exhibits are filed or furnished with this report:

3.1	Amended and Restated Articles of Incorporation of the Registrant dated 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.)
3.2	Bylaws of the Registrant dated December 7, 2007. (Incorporated by reference to Exhibit 3.2 of the Registrant s Form 8-K dated December 7, 2007.)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer furnished as required by Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

INTELLIGENT SYSTEMS CORPORATION
Registrant

Date: November 13, 2009	By: */s/ J. Leland Strange* J. Leland Strange Chief Executive Officer, President
Date: November 13, 2009	By: */s/ Bonnie L. Herron* Bonnie L. Herron Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Descriptions
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