

Information Services Group Inc.
Form 10-Q
November 09, 2012

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

OR

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

For the transition period from _____ to _____

Commission File Number 001-33287

INFORMATION SERVICES GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-5261587
(I.R.S. Employer
Identification No.)

**Two Stamford Plaza
281 Tresser Boulevard
Stamford, CT 06901**

Edgar Filing: Information Services Group Inc. - Form 10-Q

(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: **(203) 517-3100**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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

Class	Outstanding at October 26, 2012
Common Stock, \$0.001 par value	36,163,424 shares

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, would, expect, plan, anticipate, believe, estimate, the negative of such terms or other similar expressions. The actual results of ISG may vary materially from those expected or anticipated in these forward-looking statements. The realization of such forward-looking statements may be impacted by certain important unanticipated factors. Because of these and other factors that may affect ISG's operating results, past performance should not be considered as an indicator of future performance, and investors should not use historical results to anticipate results or trends in future periods. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers should carefully review the risk factors described in this and other documents that ISG files from time to time with the Securities and Exchange Commission, including subsequent Current Reports on Form 8-K, Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****INFORMATION SERVICES GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par value)**

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	\$ 14,987	\$ 24,469
Accounts receivable, net of allowance of \$730 and \$549, respectively	44,997	42,851
Deferred tax asset	3,417	3,330
Prepaid expense and other current assets	3,801	2,118
Total current assets	67,202	72,768
Restricted cash	50	51
Furniture, fixtures and equipment, net	3,175	2,954
Goodwill	34,691	34,691
Intangible assets, net	29,707	35,070
Other assets	507	945
Total assets	\$ 135,332	\$ 146,479
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	\$ 5,348	\$ 4,089
Current maturities of long-term debt	9,250	7,000
Deferred revenue	2,808	4,604
Accrued expenses	13,605	16,748
Total current liabilities	31,011	32,441
Long-term debt, net of current maturities	55,563	63,063
Deferred tax liability	8,447	10,305
Other liabilities	2,770	4,786
Total liabilities	97,791	110,595
Commitments and contingencies (Note 7)		
Stockholders equity		
Preferred stock, \$.001 par value; 10,000 shares authorized; none issued		
Common stock, \$.001 par value, 100,000 shares authorized; 36,675 shares issued and 36,103 shares outstanding at September 30, 2012 and 36,675 shares issued and 36,276 outstanding at December 31, 2011	37	37
Additional paid-in-capital	205,594	204,076
Treasury stock (572 and 399 shares, at cost)	(746)	(450)
Accumulated other comprehensive loss	(2,266)	(2,247)

Edgar Filing: Information Services Group Inc. - Form 10-Q

Accumulated deficit	(165,078)	(165,532)
Total stockholders' equity	37,541	35,884
Total liabilities and stockholders' equity	\$ 135,332	\$ 146,479

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	\$ 46,469	\$ 48,901	\$ 143,225	\$ 139,812
Operating expenses				
Direct costs and expenses for advisors	27,876	28,005	84,672	79,953
Selling, general and administrative	13,957	16,237	47,052	52,304
Depreciation and amortization	2,224	2,882	6,637	8,452
Operating income (loss)	2,412	1,777	4,864	(897)
Interest income	11	23	37	58
Interest expense	(790)	(812)	(2,501)	(2,487)
Foreign currency transaction (loss) gain	(76)	(191)	(69)	9
Income (loss) before taxes	1,557	797	2,331	(3,317)
Income tax provision	1,347	3,390	1,877	634
Net income (loss)	\$ 210	\$ (2,593)	\$ 454	\$ (3,951)
Weighted average shares outstanding:				
Basic	36,159	36,337	36,210	36,272
Diluted	38,082	36,337	37,464	36,272
Earnings (loss) per share:				
Basic	\$ 0.01	\$ (0.07)	\$ 0.01	\$ (0.11)
Diluted	\$ 0.01	\$ (0.07)	\$ 0.01	\$ (0.11)
Comprehensive income (loss):				
Net income (loss)	\$ 210	\$ (2,593)	\$ 454	\$ (3,951)
Foreign currency translation, net of tax	349	(1,692)	(19)	(466)
Comprehensive income (loss)	\$ 559	\$ (4,285)	\$ 435	\$ (4,417)

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net income (loss)	\$ 454	\$ (3,951)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation expense	1,275	1,115
Amortization of intangibles	5,363	7,337
Amortization of deferred financing costs	399	265
Compensation costs related to stock-based awards	2,191	2,397
Bad debt expense	383	685
Deferred tax benefit	(2,023)	(4,294)
Loss (gain) on disposal of furniture, fixtures and equipment	21	(13)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(2,544)	(13,389)
Prepaid expense and other current assets	(1,644)	796
Accounts payable	1,229	1,063
Deferred revenue	(1,796)	(441)
Accrued liabilities	(3,197)	(247)
Net cash provided by (used in) operating activities	111	(8,677)
Cash flows from investing activities		
Acquisitions, net of cash acquired	(24)	(13,684)
Restricted cash	1	5,750
Proceeds from sale of furniture, fixtures and equipment	21	21
Purchase of furniture, fixtures and equipment	(1,496)	(1,102)
Net cash used in investing activities	(1,519)	(9,015)
Cash flows from financing activities		
Principal payments on borrowings	(5,250)	(5,000)
Payment of contingent consideration	(2,000)	(638)
Equity securities repurchased	(1,216)	(638)
Proceeds from issuance of ESPP shares	248	232
Net cash used in financing activities	(8,218)	(5,406)
Effect of exchange rate changes on cash	144	(86)
Net decrease in cash and cash equivalents	(9,482)	(23,184)
Cash and cash equivalents, beginning of period	24,469	40,301
Cash and cash equivalents, end of period	\$ 14,987	\$ 17,117

Supplemental disclosures of cash flow information:

Noncash financing activities:

Edgar Filing: Information Services Group Inc. - Form 10-Q

Issuance of common stock for acquisition	7,980
Issuance of convertible debt for acquisition	6,250

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

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 1 DESCRIPTION OF ORGANIZATION AND BUSINESS OPERATIONS

Information Services Group, Inc. (the Company) was incorporated in Delaware on July 20, 2006. The Company was formed to acquire, through a merger, capital stock exchange, asset or stock acquisition or other similar business combination one or more domestic or international operating businesses.

On November 16, 2007, we consummated the acquisition of TPI Advisory Services Americas, Inc., a Texas corporation (TPI), pursuant to a Purchase Agreement dated April 24, 2007, as amended on September 30, 2007, by and between MCP-TPI Holdings, LLC, a Texas limited liability company (MCP-TPI), and the Company. For accounting purposes, the TPI acquisition has been treated as a business combination. TPI operate as a fact-based sourcing advisory firm specializing in the assessment, evaluation, negotiation and management of service contracts between our clients and those clients' outside service providers and their internal shared service organizations. These service contracts typically involve the clients' information technology (IT) infrastructure or software applications development, data and voice communications, or IT-enabled business processes such as the clients' internal finance and accounting functions, human resources, call center operations, or supply chain procurement.

On January 4, 2011, the Company completed the acquisition of Compass. Compass is an independent global provider of business and information technology benchmarking, performance improvement, data and analytics services. It was founded in 1980 and headquartered in the United Kingdom and has 180 employees in 16 countries serving nearly 250 clients worldwide. Compass uses benchmarking to support fact-based decision making, analysis to optimize cost reduction, and tools and techniques to manage business performance. For accounting purposes, the acquisition of Compass has been treated as a business combination.

On February 10, 2011 the Company completed the acquisition of STA Consulting (Salvaggio, Teal & Associates) an independent information technology advisor serving the public sector. STA Consulting advises clients on information technology strategic planning and the acquisition and implementation of new Enterprise Resource Planning (ERP) and other enterprise administration and management systems. STA Consulting was founded in 1997 and is based in Austin, Texas with approximately 40 professionals experienced in information systems consulting in public sector areas such as government operations, IT and project management, contract negotiations, financial management, procurement, human resources and payroll. STA Consulting works with such states as Alaska, Kansas, Kentucky, Louisiana, Mississippi and West Virginia. For accounting purposes, the acquisition of STA Consulting has been treated as a business combination.

During the fourth quarter of 2011, we merged our individual corporate brands into one globally integrated business under the ISG brand. We have retained our legacy brands to identify specific products and services we are known for including The TPI Index, TPI Sourcing and Compass Benchmarks.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements as of September 30, 2012 and for the three and nine months ended September 30, 2012 and 2011, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and pursuant to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are considered necessary for a fair presentation of the financial position of the Company as of September 30, 2012, the results of operations for the three and nine months ended September 30, 2012 and 2011 and the cash flows for the nine months ended September 30, 2012 and 2011. The condensed consolidated balance sheet as of December 31, 2011 has been derived from the Company's audited consolidated financial statements. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

Certain information and disclosures normally included in the notes to annual financial statements prepared in accordance with GAAP have been omitted from these interim financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the financial statements for the fiscal year ended December 31, 2011, which are included in the Company's 2011 Form 10-K filed with the SEC.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the periods reported. Actual results may differ from those estimates. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the proportional performance method of accounting affect the amounts of revenues, expenses, unbilled receivables and deferred revenue. Numerous internal and external factors can affect estimates. Estimates are also used for but not limited to: allowance for doubtful accounts, useful lives of furniture, fixtures and equipment, depreciation expense, fair value assumptions in analyzing goodwill and intangible asset impairments, income taxes and deferred tax asset valuation, and the valuation of stock based compensation.

Fair Value

The carrying value of the Company's cash and cash equivalents, receivables, accounts payable, other current liabilities, and accrued interest approximate fair value.

Fair value is the price that would be received upon a sale of an asset or paid upon a transfer of a liability in an orderly transaction between market participants at the measurement date (exit price). Market participants can use market data or assumptions in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market-corroborated, or generally unobservable. The use of unobservable inputs is intended to allow for fair value determinations in situations where there is little, if any, market activity for the asset or liability at the measurement date. Under the fair-value hierarchy:

- Level 1 measurements include unadjusted quoted market prices for identical assets or liabilities in an active market;
- Level 2 measurements include quoted market prices for identical assets or liabilities in an active market that have been adjusted for items such as effects of restrictions for transferability and those that are not quoted but are observable through corroboration with observable market data, including quoted market prices for similar assets; and

Edgar Filing: Information Services Group Inc. - Form 10-Q

- Level 3 measurements include those that are unobservable and of a highly subjective measure.

The Company held investments in cash equivalent money market funds of approximately \$20 thousand and \$1.1 million at September 30, 2012 and December 31, 2011, respectively. The Company considers the fair value of cash equivalent money market funds to be classified within Level 1 of the fair value hierarchy.

The Company's financial instruments include outstanding borrowings of \$64.8 million at September 30, 2012 and \$70.1 million at December 31, 2011, which are carried at amortized cost. The fair values of these instruments are classified within Level 3 of the fair value hierarchy. The fair value of the Company's outstanding borrowings is approximately \$64.6 million and \$67.1 million at September 30, 2012 and December 31, 2011, respectively. The fair values of these instruments have been estimated using a discounted cash flow analysis based on the Company's incremental borrowing rate for similar borrowing arrangements. The incremental borrowing rate used to discount future cash flows ranged from 3.69% to 4.00%. The Company also considered recent transactions of peer group companies for similar instruments with comparable terms and maturities as well as an analysis of current market conditions.

The fair value of the Company's contingent consideration liability related to the STA acquisition was \$2.8 million and \$6.8 million at September 30, 2012 and December 31, 2011, respectively. In the third quarter of 2012, the Company reduced the contingent consideration liability by \$1.9 million based on the latest estimates of future profit levels due to increased competition in the public sector and increased pricing pressures. The Company paid \$2.0 million related to the contingent consideration during the second quarter of 2012 related to 2011 performance. The fair value measurement of this contingent consideration is classified within Level 3 of the fair value hierarchy and reflects the Company's own assumptions in measuring fair values using the income approach. In developing these estimates, the Company considered certain performance projections, historical results, and industry trends. This amount was estimated through a valuation model that incorporated industry-based, probability-weighted assumptions related to the achievement of these milestones and thus the likelihood of us making payments. These cash outflow projections have been discounted using a rate of 2.3%, which is the after-tax cost of debt financing for market participants.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Recently Issued Accounting Pronouncements

In July 2012, the FASB amended the Intangibles - Goodwill and Other Topic of the ASC that allows us to make a qualitative assessment of whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If, after assessing the relevant information, we determine it is more likely than not that the fair value is more than the carrying amount, no additional analysis is necessary. If we determine it is more likely than not that the fair value is less than the carrying amount, then we are required to proceed to the quantitative approach. The amended guidance is effective for us in our annual test in the fourth quarter of 2013, and adoption is not expected to impact our consolidated financial condition or results of operations.

In September 2011, the FASB amended the Intangibles - Goodwill and Other Topic of the ASC that allows us to make a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If, after assessing the relevant information, we determine it is more likely than not that the fair value is more than the carrying amount, no additional analysis is necessary. If we determine it is more likely than not that the fair value is less than the carrying amount, then we are required to proceed to the quantitative approach. The amended guidance is effective for us in our annual test in the fourth quarter of 2012, and adoption is not expected to impact our consolidated financial condition or results of operations.

NOTE 4 NET INCOME (LOSS) PER COMMON SHARE

Basic earnings (loss) per share is computed by dividing net (loss) income available to common stockholders by the weighted average number of common shares outstanding for the period. The 250,000 STA shares were excluded from basic and diluted earnings per share since the contingency has not been met as of the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would share in the net income of the Company. For the three and nine months ended September 30, 2012, the effect of 5.0 million warrants, 0.3 million stock appreciation rights (SARs) have not been considered in the diluted earnings per share, since the market price of the stock was less than the exercise price during the period in the computation. In addition, 1.2 million restricted shares have not been considered in the diluted earnings per share calculation for the three and nine months ended September 30, 2012, as the effect would be anti-dilutive. For the three and nine months ended September 30, 2011, the effect of 1.6 million shares related to the Company's convertible debt, 5.0 million warrants, 0.4 million SARs and 3.2 million restricted shares have not been considered in the diluted earnings per share calculation, as the effect would be anti-dilutive.

The following tables set forth the computation of basic and diluted earnings (loss) per share:

Three Months

Nine Months

Edgar Filing: Information Services Group Inc. - Form 10-Q

	Ended September 30,		Ended September 30,		
	2012	2011	2012	2011	
Basic:					
Net income (loss)	\$	210	\$ (2,593)	\$ 454	\$ (3,951)
Weighted average common shares		36,159	36,337	36,210	36,272
Basic income (loss) per share	\$	0.01	\$ (0.07)	\$ 0.01	\$ (0.11)
Diluted:					
Net income (loss)	\$	210	\$ (2,593)	\$ 454	\$ (3,951)
Interest expense of convertible debt, net of tax		8		35	
Net income (loss), as adjusted	\$	218	\$ (2,593)	\$ 489	\$ (3,951)
Basic weighted average common shares		36,159	36,337	36,210	36,272
Potential common shares		1,923		1,254	
Diluted weighted average common shares		38,082	36,337	37,464	36,272
Diluted income (loss) per share	\$	0.01	\$ (0.07)	\$ 0.01	\$ (0.11)

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 5 ACQUISITION

On April 1, 2012, the Company executed an agreement for the purchase of the entire business and assets of Compass Consulting Oy, previously a franchise incorporated in Finland which the Company had no ownership interest for approximately \$0.1 million plus deferred consideration of \$0.01 million plus 50% of the amount by which the relevant profit exceeds targeted profit for the twelve month period ended March 31, 2012. The targeted profit for the twelve month period ended March 31, 2012 was not achieved. This transaction has been accounted for as a business combination and the purchase price has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of the acquisition date. There was no goodwill recorded as a part of this business combination.

NOTE 6 INCOME TAXES

The Company's effective tax rate for the three and nine months ended September 30, 2012 was 86.5% and 80.5% based on pretax income of \$1.6 million and \$2.3 million, respectively. Our effective tax rate for the nine months ended September 30, 2012 is higher than the statutory rate primarily due to the reversal of deferred tax assets associated with vested restricted stock units of \$0.2 million and an increase to the valuation allowance of \$0.6 million related to foreign tax credits. This compared to 425% and (19.1)% for the three and nine months ended September 30, 2011, respectively.

As of September 30, 2012, the Company had total unrecognized tax benefits of approximately \$2.3 million of which approximately \$2.3 million of this benefit would impact the Company's effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax provision in its condensed consolidated statement of operations. As of September 30, 2012, the Company's accrual of interest and penalties were \$0.4 million.

NOTE 7 COMMITMENTS AND CONTINGENCIES

The Company is subject to contingencies which arise through the ordinary course of business. All liabilities of which management is aware are properly reflected in the financial statements at September 30, 2012 and December 31, 2011.

STA Consulting Contingent Consideration

Edgar Filing: Information Services Group Inc. - Form 10-Q

As of September 30, 2012, the Company has recorded a liability of \$2.8 million representing the estimated fair value of contingent consideration related to the acquisition of STA Consulting, of which all is classified as noncurrent and included in other liabilities on the condensed consolidated balance sheet. In the third quarter of 2012, the Company reduced the contingent consideration liability by \$1.9 million based on the latest estimates of future profit levels due to increased competition in the public sector and increased pricing pressures. This reduction decreased selling, general and administrative expenses by \$1.9 million for the three and nine months ended September 30, 2012 in the accompanying condensed consolidated statement of comprehensive income (loss). The Company paid \$2.0 million in the second quarter of 2012 and expects to pay the remaining contingent liability in the first quarter of 2015 and the first quarter of 2016. No payments are currently anticipated in 2013 or 2014 related to 2012 and 2013 performance.

NOTE 8 SEGMENT AND GEOGRAPHICAL INFORMATION

The Company operates in one segment consisting primarily of fact-based sourcing advisory services. The Company operates principally in the Americas, Europe and Asia Pacific.

Geographical revenue information for the segment is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues				
Americas	\$ 26,842	\$ 24,006	\$ 77,927	\$ 66,006
Europe	14,240	18,341	46,008	56,298
Asia Pacific	5,387	6,554	19,290	17,508
	\$ 46,469	\$ 48,901	\$ 143,225	\$ 139,812

The segregation of revenues by geographic region is based upon the location of the legal entity performing the services. The Company does not measure or monitor gross profit or operating income by geography for the purposes of making operating decisions or allocating resources.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 9 FINANCING ARRANGEMENTS AND LONG-TERM DEBT

The Company has outstanding a substantial amount of debt, which may limit our ability to fund general corporate requirements and obtain additional financing, limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic and industry conditions.

The Company has incurred a substantial amount of indebtedness to finance the acquisition of TPI, including transaction costs and deferred underwriting fees. On November 16, 2007, our wholly-owned subsidiary International Consulting Acquisition Corp. (ICAC) entered into a senior secured credit facility comprised of a \$95.0 million term loan facility and a \$10.0 million revolving credit facility. On November 16, 2007, ICAC borrowed \$95.0 million under the term loan facility to finance the purchase price for our acquisition of TPI and to pay transaction costs. As a result of the substantial fixed costs associated with the debt obligations, we expect that:

- a decrease in revenues will result in a disproportionately greater percentage decrease in earnings;
- we may not have sufficient liquidity to fund all of these fixed costs if our revenues decline or costs increase;
- we may have to use our working capital to fund these fixed costs instead of funding general corporate requirements, including capital expenditures;
- we may not have sufficient liquidity to respond to business opportunities, competitive developments and adverse economic conditions; and
- our results of operations will be adversely affected if interest rates increase because, based on our current outstanding term loan borrowings in the amount of \$58.6 million, a 1% increase in interest rates would result in a pre-tax impact on earnings of approximately \$0.6 million per year.

Edgar Filing: Information Services Group Inc. - Form 10-Q

These debt obligations may also impair our ability to obtain additional financing, if needed, and our flexibility in the conduct of our business. Our indebtedness under the senior secured revolving credit facility is secured by substantially all of our assets, leaving us with limited collateral for additional financing. Moreover, the terms of our indebtedness under the senior secured revolving credit facility restrict our ability to take certain actions, including the incurrence of additional indebtedness, mergers and acquisitions, investments and asset sales. Our ability to pay the fixed costs associated with our debt obligations will depend on our operating performance and cash flow, which in turn depend on general economic conditions and the advisory services market. A failure to pay interest or indebtedness when due could result in a variety of adverse consequences, including the acceleration of our indebtedness. In such a situation, it is unlikely that we would be able to fulfill our obligations under or repay the accelerated indebtedness or otherwise cover our fixed costs.

The 2007 Credit Agreement contains a number of covenants that, among other things, place restrictions on matters customarily restricted in senior secured credit facilities, including restrictions on indebtedness (including guarantee obligations), liens, fundamental changes, sales or disposition of property or assets, investments (including loans, advances, guarantees and acquisitions), transaction with affiliates, dividends and other payments in respect of capital stock, optional payments and modifications of other material debt instruments, negative pledges and agreements restricting subsidiary distributions and changes in line of business. The 2007 Credit Agreement contains customary events of default, including cross-default to other material agreements, judgment default and change of control.

The Company is required to comply with a total leverage ratio as defined in the 2007 Credit Agreement. The total leverage ratio is defined as the ratio of consolidated indebtedness to consolidated earnings before interest, taxes, depreciation and amortization, subject to certain exclusions. The 2007 Credit Agreement includes quarterly financial covenants that require us to maintain a maximum total leverage ratio (as defined in the 2007 Credit Agreement). As of September 30, 2012, our maximum total leverage ratio was 3.00 to 1.00 and we were in compliance with all covenants contained in the 2007 Credit Agreement. The maximum total leverage ratio will continue to decline over the life of the 2007 Credit Agreement. The maximum total leverage ratio is 3.00 for the quarter ended September 30, 2012 and through the period ending December 31, 2012 and will continue to decline thereafter. We currently expect to be in compliance with the covenants contained within the 2007 Credit Agreement. In the event we are unable to remain in compliance with the debt covenants associated with the 2007 Credit Agreement we have alternative options available to us including, but not limited to, the ability to make a prepayment on our debt without penalty to bring the actual leverage ratio into compliance. Our available cash balances and liquidity will be negatively impacted should such prepayment be necessary. In addition, should the Company's revenues not meet our forecast, the Company has the ability to reduce various expenditures to minimize the impact to the leverage ratio. Such actions may include reductions to headcount, variable compensation, marketing expenses, conferences and non-billable travel.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

On January 4, 2011, as part of the consideration for the acquisition of Compass, we issued an aggregate of \$6.3 million in convertible notes to Compass (the Notes). The Notes mature on January 4, 2018 and interest is payable on the outstanding principal amount, computed daily, at the rate of 3.875% per annum on January 31 of each calendar year and on the seventh anniversary of the date of the Notes. The Notes are subject to transfer restrictions until January 31, 2013. If the price of our common stock on the Nasdaq Global Market exceeds \$4 per share for 60 consecutive trading days (the Trigger Event), the holder of the Notes may convert all (but not less than all) of the outstanding principal amount of the Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger event, we may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

On March 13, 2012, our lenders agreed to allow ICAC to include the results of operations of Compass in the calculation of our leverage ratio. ICAC also received approval to increase the annual cash dividend payable to ISG to \$2.0 million.

We anticipate that our current cash and the ongoing cash flows from our operations will be adequate to meet our working capital and capital expenditure needs for at least the next twelve months. The anticipated cash needs of our business could change significantly if we pursue and complete additional business acquisitions, if our business plans change, if economic conditions change from those currently prevailing or from those now anticipated, or if other unexpected circumstances arise that may have a material effect on the cash flow or profitability of our business. If we require additional capital resources to grow our business, either internally or through acquisition, we may seek to sell additional equity securities or to secure debt financing. The sale of additional equity securities or certain forms of debt financing could result in additional dilution to our stockholders. We may not be able to obtain financing arrangements in amounts or on terms acceptable to us in the future.

As of September 30, 2012, the total principal outstanding under the term loan facility was \$58.6 million. There were no borrowings under the revolving credit facility during the nine months ended September 30, 2012 or 2011. Additional mandatory principal repayments totaling \$1.8 million and \$10.0 million will be due in 2012 and 2013 respectively with the remaining principal repayments due in 2014. The final mandatory term loan principal repayment will be due on November 16, 2014, which is the maturity date for the term loan.

NOTE 10 GOODWILL

Our goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired at the date of acquisition.

During the third quarter of 2012, management determined that a triggering event had occurred due to a revision in forecasted earnings as a result of macro-economic environment in Europe and continued unfavorable currency translation. Accordingly, the Company evaluated the carrying value of goodwill.

Edgar Filing: Information Services Group Inc. - Form 10-Q

We performed a two-step impairment test on goodwill. Step one compares the fair value of the reporting unit to its carrying amount, including goodwill. If the carrying value of the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test whereby the carrying value of the reporting unit's goodwill is compared to its implied fair value. If the carrying value of the goodwill exceeds the implied fair value, an impairment loss equal to the difference is recorded.

In performing the first step of the impairment test on goodwill, we determined the fair value of the reporting unit using both a market and income approach. The income approach utilizes a discounted cash flow model and is based on projections of future operations of the reporting unit as of the valuation date. The market approach is based on the guideline public company method which considers multiples of comparable companies. The Company selected an amount in the first quartile of such comparable companies. The discounted cash flow model assumed revenue growth rates of approximately 3% per year. We employed a rate of 13.5% to discount future excess cash flows. As a result of the step one test performed, the fair value of our reporting unit exceeded the carrying value. Accordingly, step two was not performed or required. However, if future downturns in our business, continued deterioration of economic conditions, or our stock trading below book value per share may result in an impairment charge in future periods, which could adversely affect our results of operations for those periods.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with our financial statements and related notes included elsewhere in this report. Except for historical information, the discussion in this report contains certain forward-looking statements that involve risks and uncertainties. We have based these forward-looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward-looking statements by terminology, such as may, should, could, predict, potential, continue, expect, anticipate, intend, plan, believe, estimate, forecast and similar expressions (or the negative of such expressions.) Forward-looking statements include statements concerning 2012 revenue growth rates and capital expenditures. Forward-looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, the volatility of our stock price, and current competitive conditions. As a result, these statements are subject to various risks and uncertainties. For a discussion of material risks and uncertainties that the Company faces, see the discussion in our 2011 Form 10-K titled Risk Factors.

BUSINESS OVERVIEW

Information Services Group, Inc. (ISG) (NASDAQ: III) is a leading technology insights, market intelligence and advisory services company serving more than 500 clients around the world to help them achieve operational excellence. We support private and public sector organizations to transform and optimize their operational environments through research, benchmarking, consulting and managed services with a focus on information technology, business process transformation, program management services and enterprise resource planning. Clients look to us for unique insights and innovative solutions for leveraging technology, our deep data source, and more than five decades of experience of global leadership in information and advisory services. Based in Stamford, Connecticut, we have over 800 employees and operate in 21 countries.

Our strategy is to strengthen our existing market position and develop new services and products to support future growth plans. As a result, we are focused on growing our existing service model, expanding geographically, developing new industry sectors, productizing market data assets, expanding our managed services offering and growing via acquisition. Although we do not expect any adverse conditions that will impact our ability to execute against our strategy over the next twelve months, the more significant factors that could limit our ability to grow in these areas include global macro-economic conditions and the impact on the overall sourcing market, competition, our ability to retain advisors and reductions in discretionary spending with our top strategic accounts or other significant client events. Other areas that could impact the business would also include natural disasters, legislative and regulatory changes and capital market disruptions.

We derive our revenues from fees and reimbursable expenses for professional services. A majority of our revenues are generated under hourly or daily rates billed on a time and expense basis. Clients are typically invoiced on a monthly basis, with revenue recognized as the services are provided. There are also client engagements in which we are paid a fixed amount for our services, often referred to as fixed fee billings. This may be one single amount covering the whole engagement or several amounts for various phases or functions. From time to time, we earn incremental revenues, in addition to hourly or fixed fee billings, which are contingent on the attainment of certain contractual milestones or objectives. Such revenues may cause unusual variations in quarterly revenues and operating results.

Our results are impacted principally by our full-time consultants' utilization rate, the number of business days in each quarter and the number of our revenue-generating professionals who are available to work. Our utilization rate can be negatively affected by increased hiring because there is generally a transition period for new professionals that result in a temporary drop in our utilization rate. Our utilization rate can also be affected by seasonal variations in the demand for our services from our clients. The number of business work days is also affected by the number of vacation days taken by our consultants and holidays in each quarter. We typically have fewer business work days available in the fourth quarter of the year, which can impact revenues during that period. Time-and-expense engagements do not provide us with a high degree of predictability as to performance in future periods. Unexpected changes in the demand for our services can result in significant variations in utilization and revenues and present a challenge to optimal hiring and staffing. The volume of work performed for any particular client can vary widely from period to period.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012 AND SEPTEMBER 30, 2011

On January 4, 2011, ISG completed the acquisition of Compass. Compass is an independent global provider of business and information technology benchmarking, performance improvement, data and analytics services. Compass uses benchmarking to support fact-based decision making, analysis to optimize cost reduction, and tools and techniques to manage business performance.

On February 10, 2011 ISG completed the acquisition of STA Consulting (Salvaggio, Teal & Associates) an independent information technology advisor serving the public sector. STA Consulting advises clients on information technology strategic planning and the acquisition and implementation of new Enterprise Resource Planning (ERP) and other enterprise administration and management systems.

Revenues

Revenues are generally derived from engagements priced on a time and materials basis as well as various fixed fee projects, and are recorded based on actual time worked and are recognized as the services are performed. Revenues related to materials (mainly out-of-pocket expenses such as airfare, lodging and meals) required during an engagement generally do not include a profit mark-up and can be charged and reimbursed discretely or as part of the overall fee structure. Invoices are issued to clients at least monthly.

We operate in one segment, fact-based sourcing advisory services. We operate principally in the Americas, Europe, and Asia Pacific. Our foreign operations are subject to local government regulations and to the uncertainties of the economic and political conditions of those areas.

Geographical revenue information for the segment is as follows:

Geographic Area	Three Months Ended September 30, (in thousands)				Percent Change %
	2012	2011	Change		
Americas	\$ 26,842	\$ 24,006	\$ 2,836		12
Europe	14,240	18,341	(4,101)		(22)
Asia Pacific	5,387	6,554	(1,167)		(18)
Total revenues	\$ 46,469	\$ 48,901	\$ (2,432)		(5)

The net decrease in revenues of \$2.4 million in 2012 was attributable principally to a 22% decrease in Europe to \$14.2 million and an 18% decrease in Asia Pacific revenues to \$5.4 million. The decrease in revenues is primarily due to lower volumes in sourcing related engagements in Europe and Asia Pacific regions. These decreases were offset by a 12% increase in Americas primarily due to an increase in managed services revenue. The translation of foreign currency into US dollars also had a negative impact on performance compared to the prior year.

Operating Expenses

Edgar Filing: Information Services Group Inc. - Form 10-Q

The following table presents a breakdown of our operating expenses by category:

Operating Expenses	Three Months Ended September 30, (in thousands)			Change	Percent Change %
	2012	2011			
Direct costs and expenses for advisors	\$ 27,876	\$ 28,005	\$	(129)	
Selling, general and administrative	13,957	16,237		(2,280)	(14)
Depreciation and amortization	2,224	2,882		(658)	(23)
Total operating expenses	\$ 44,057	\$ 47,124	\$	(3,067)	(7)

Total operating expenses decreased \$3.1 million or 7% for the quarter with decreases in selling, general and administrative (SG&A) (14%) and depreciation and amortization (23%) expenses. Lower expenses were driven by reduced travel, conferences and occupancy expenses. We did not record any restructuring or deal costs during the third

Edgar Filing: Information Services Group Inc. - Form 10-Q

quarter of 2012 compared to \$0.6 million recorded in the third quarter of 2011. These cost decreases were partially offset by higher compensation, computer and bad debt expenses. Lower SG&A levels were mostly driven by a \$1.9 million reduction in the contingent liability related to the STA Consulting earn out based on future projected profit levels. The impact of foreign currency translation into US dollars also drove costs lower compared to the same prior 2011 period.

Compensation costs consist of a mix of fixed and variable salaries, annual bonuses, benefits and pension plan contributions. A portion of compensation expenses for certain billable employees are allocated between direct costs and selling, general and administrative costs based on relative time spent between billable and non-billable activities. Bonus compensation is determined based on achievement against Company financial and individual targets, and is accrued monthly throughout the year based on management's estimates of target achievement. Statutory and elective pension plans are offered to employees as appropriate. Direct costs also include employee taxes, health insurance, workers compensation and disability insurance.

Sales and marketing costs consist principally of compensation expense related to business development, proposal preparation and delivery and negotiation of new client contracts. Costs also include travel expenses relating to the pursuit of sales opportunities, expenses for hosting periodic client conferences, public relations activities, participation in industry conferences, industry relations, website maintenance and business intelligence activities. The Company maintains a dedicated global marketing function responsible for developing and managing sales campaigns, brand promotion, the TPI Index and assembling proposals.

We maintain a comprehensive program for training and professional development. Related expenses include product training, updates on new service offerings or methodologies and development of project management skills. Also included in training and professional development are expenses associated with the development, enhancement and maintenance of our proprietary methodologies and tools and the systems that support them.

General and administrative expenses consist principally of executive management compensation, allocations of billable employee compensation related to general management activities, IT infrastructure, and costs for the finance, accounting, information technology and human resource functions. General and administrative costs also reflect continued investment associated with implementing and operating client and employee management systems. Because our billable personnel operate primarily on client premises, all occupancy expenses are recorded as general and administrative.

Depreciation and amortization expense in the third quarter of 2012 and 2011 was \$2.2 million and \$2.9 million, respectively. The decrease of \$0.7 million in depreciation and amortization expense was primarily due to decrease in amortization as a result of intangible assets that were fully amortized in 2011. Our fixed assets consist of furniture, fixtures, equipment (mainly personal computers) and leasehold improvements. Depreciation expense is generally computed by applying the straight-line method over the estimated useful lives of assets. We also capitalize some costs associated with the purchase and development of internal-use software, system conversions and website development costs. These costs are amortized over the estimated useful life of the software or system.

We amortize our intangible assets (e.g. client relationships and databases) over their estimated useful lives. Goodwill related to acquisitions is not amortized but is subject to annual impairment testing. As of November 1, 2011, trademark and trade names acquired in our acquisitions were reclassified from indefinite to definite lived assets and are being amortized over their estimated useful lives.

Other (Expense), Net

The following table presents a breakdown of other (expense), net:

	Three Months Ended September 30, (in thousands)				Percent Change %
	2012	2011	Change		
Interest income	\$ 11	\$ 23	\$ (12)		(52)
Interest expense	(790)	(812)	22		3
Foreign currency loss	(76)	(191)	115		60
Total other expense, net	\$ (855)	\$ (980)	\$ 125		13

Income Tax Expense

Our quarterly effective tax rate varies from period to period based on the mix of earnings among the various state and foreign tax jurisdictions in which business is conducted and the level of non-deductible expenses projected to be incurred during the current fiscal year. Our effective tax rate for the three months ended September 30, 2012 was 86.5% compared to

Edgar Filing: Information Services Group Inc. - Form 10-Q

425% for the three months ended September 30, 2011. Our effective tax rate is higher than the statutory rate primarily due to the reversal of deferred tax assets associated with vested restricted stock units of \$0.1 million and an increase in the valuation allowance of \$0.6 million related to the foreign tax credits. Our operations resulted in pre-tax income of \$1.6 million and a tax provision of \$1.4 million at the 86.5% effective tax rate for the three months ended September 30, 2012.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND SEPTEMBER 30, 2011

The results for the nine months ended September 30, 2011 discussed below include the operations of Compass from January 4, 2011 to September 30, 2011 and STA Consulting from February 10, 2011 to September 30, 2011.

Revenues

Geographical revenue information for the segment is as follows:

Geographic Area	Nine Months Ended September 30, (in thousands)			Percent Change %
	2012	2011	Change	
Americas	\$ 77,927	\$ 66,006	\$ 11,921	18
Europe	46,008	56,298	(10,290)	(18)
Asia Pacific	19,290	17,508	1,782	10
Total revenues	\$ 143,225	\$ 139,812	\$ 3,413	2

The net increase in revenues of \$3.4 million or 2% in 2012 was attributable principally to an 18% increase in Americas revenues to \$77.9 million and a 10% increase in Asia Pacific revenues to \$19.3 million. The increase in revenues is primarily due to higher levels of sourcing activity in Americas and Asia Pacific region, attributable to increases in managed services revenue. These increases were offset by an 18% reduction in Europe primarily due to lower volumes in sourcing related engagements. The translation of foreign currency into US dollars also negatively impacted performance compared to prior year.

Operating Expenses

The following table presents a breakdown of our operating expenses by category:

Operating Expenses	Nine Months Ended September 30, (in thousands)			Percent Change %
	2012	2011	Change	

Edgar Filing: Information Services Group Inc. - Form 10-Q

Direct costs and expenses for advisors	\$	84,672	\$	79,953	\$	4,719	6
Selling, general and administrative		47,052		52,304		(5,252)	(10)
Depreciation and amortization		6,637		8,452		(1,815)	(21)
Total operating expenses	\$	138,361	\$	140,709	\$	(2,348)	(2)

Total operating expenses decreased \$2.3 million or 2% for the first nine months of 2012 with decreases in SG&A expenses (10%) offset by increases in direct expenses (6%). Lower costs were driven by lower travel, occupancy, conference, bad debt and marketing expenses. We did not record any restructuring or deal costs during the first nine months of 2012 compared to \$3.1 million recorded in the first nine months of 2011. These cost decreases were partially offset by higher outside professional services, compensation and benefits, contract labor, and computer expenses. Lower SG&A levels were mostly driven by a \$1.9 million reduction in the contingent liability related to the STA Consulting earn out based on latest estimates of future profit levels. The impact of foreign currency translation into US dollars also drove costs lower compared to the same prior 2011 period.

Depreciation and amortization expense in the first nine months of 2012 and 2011 was \$6.6 million and \$8.4 million, respectively. The decrease of \$1.8 million in depreciation and amortization expense was primarily due to decrease in amortization as a result of intangible assets that were fully amortized in 2011.

Other (Expense), Net

The following table presents a breakdown of other (expense), net:

	Nine Months Ended September 30, (in thousands)			Percent Change %
	2012	2011	Change	
Interest income	\$ 37	\$ 58	\$ (21)	(36)
Interest expense	(2,501)	(2,487)	(14)	(1)
Foreign currency (loss) gain	(69)	9	(78)	(867)
Total other expense, net	\$ (2,533)	\$ (2,420)	\$ (113)	(5)

Income Tax Expense

Our effective tax rate for the nine months ended September 30, 2012 was 80.5% compared to (19.1)% for the nine months ended September 30, 2011. Our effective tax rate is higher than the statutory rate primarily due to the reversal of deferred tax assets associated with vested restricted stock units of \$0.2 million and an increase in the valuation allowance of \$0.6 million related to the foreign tax credits. Our operations resulted in a pre-tax income of \$2.3 million and a tax provision of \$1.9 million at the 80.5% effective tax rate for the nine months ended September 30, 2012.

LIQUIDITY AND CAPITAL RESOURCES**Liquidity**

Our primary sources of liquidity are cash flows from operations, existing cash and cash equivalents and our revolving credit facility. Operating assets and liabilities consist primarily of receivables from billed and unbilled services, accounts payable, accrued expenses, and accrued payroll and related benefits. The volume of billings and timing of collections and payments affect these account balances.

As of September 30, 2012, our cash and cash equivalents were \$15.0 million, a net decrease of \$9.5 million from December 31, 2011, which was primarily attributable to the following:

- net cash provided by from operating activities of \$0.1 million;
- payments of principal amounts due on the debt of \$5.3 million.

- payment of STA Consulting contingent consideration of \$2.0 million.
- capital expenditures for furniture, fixtures and equipment of \$1.5 million; and
- equity repurchases of \$1.2 million;

Capital Resources

We have outstanding a substantial amount of debt, which may limit our ability to fund general corporate requirements and obtain additional financing, limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic and industry conditions.

We incurred a substantial amount of indebtedness to finance the acquisition of TPI, including transaction costs and deferred underwriting fees. On November 16, 2007, our wholly-owned subsidiary International Consulting Acquisition Corp. (ICAC) entered into a senior secured credit facility comprised of a \$95.0 million term loan facility and a \$10.0 million revolving credit facility. On November 16, 2007, ICAC borrowed \$95.0 million under the term loan facility to finance the purchase price for our acquisition of TPI and to pay transaction costs. As a result of the substantial fixed costs associated with the debt obligations, we expect that:

- a decrease in revenues will result in a disproportionately greater percentage decrease in earnings;
- we may not have sufficient liquidity to fund all of these fixed costs if our revenues decline or costs increase;
- we may have to use our working capital to fund these fixed costs instead of funding general corporate requirements, including capital expenditures;
- we may not have sufficient liquidity to respond to business opportunities, competitive developments and adverse economic conditions; and

Edgar Filing: Information Services Group Inc. - Form 10-Q

- our results of operations will be adversely affected if interest rates increase because, based on our current outstanding term loan borrowings in the amount of \$58.6 million, a 1% increase in interest rates would result in a pre-tax impact on earnings of approximately \$0.6 million per year.

These debt obligations may also impair our ability to obtain additional financing, if needed, and our flexibility in the conduct of our business. Our indebtedness under the senior secured revolving credit facility is secured by substantially all of our assets, leaving us with limited collateral for additional financing. Moreover, the terms of our indebtedness under the senior secured revolving credit facility restrict our ability to take certain actions, including the incurrence of additional indebtedness, mergers and acquisitions, investments and asset sales. Our ability to pay the fixed costs associated with our debt obligations will depend on our operating performance and cash flow, which in turn depend on general economic conditions and the advisory services market. A failure to pay interest or indebtedness when due could result in a variety of adverse consequences, including the acceleration of our indebtedness. In such a situation, it is unlikely that we would be able to fulfill our obligations under or repay the accelerated indebtedness or otherwise cover our fixed costs.

The 2007 Credit Agreement contains a number of covenants that, among other things, place restrictions on matters customarily restricted in senior secured credit facilities, including restrictions on indebtedness (including guarantee obligations), liens, fundamental changes, sales or disposition of property or assets, investments (including loans, advances, guarantees and acquisitions), transaction with affiliates, dividends and other payments in respect of capital stock, optional payments and modifications of other material debt instruments, negative pledges and agreements restricting subsidiary distributions and changes in line of business. The 2007 Credit Agreement contains customary events of default, including cross-default to other material agreements, judgment default and change of control.

We are required to comply with a total leverage ratio as defined in the 2007 Credit Agreement. The total leverage ratio is defined as the ratio of consolidated indebtedness to consolidated earnings before interest, taxes, depreciation and amortization, subject to certain exclusions. The 2007 Credit Agreement includes quarterly financial covenants that require us to maintain a maximum total leverage ratio (as defined in the 2007 Credit Agreement). As of September 30, 2012, our maximum total leverage ratio was 3.00 to 1.00 and we were in compliance with all covenants contained in the 2007 Credit Agreement. The maximum total leverage ratio will continue to decline over the life of the 2007 Credit Agreement. The maximum total leverage ratio is 3.00 for the quarter ended September 30, 2012 and through the period ending December 31, 2012 and will continue to decline thereafter. We currently expect to be in compliance with the covenants contained within the 2007 Credit Agreement. In the event we are unable to remain in compliance with the debt covenants associated with the 2007 Credit Agreement we have alternative options available to us including, but not limited to, the ability to make a prepayment on our debt without penalty to bring the actual leverage ratio into compliance. Our available cash balances and liquidity will be negatively impacted should such prepayment be necessary. In addition, should our revenues not meet our forecast, we have the ability to reduce various expenditures to minimize the impact to the leverage ratio. Such actions may include reductions to headcount, variable compensation, marketing expenses, conferences and non-billable travel.

On January 4, 2011, as part of the consideration for the acquisition of Compass, we issued an aggregate of \$6.3 million in convertible notes to Compass (the Notes). The Notes mature on January 4, 2018 and interest is payable on the outstanding principal amount, computed daily, at the rate of 3.875% per annum on January 31 of each calendar year and on the seventh anniversary of the date of the Notes. The Notes are subject to transfer restrictions until January 31, 2013. If the price of our common stock on the Nasdaq Global Market exceeds \$4 per share for 60 consecutive trading days (the Trigger Event), the holder of the Notes may convert all (but not less than all) of the outstanding principal amount of the Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger event, we may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

On March 13, 2012, our lenders agreed to allow ICAC to include the results of operations of Compass in the calculation of our leverage ratio. ICAC also received approval to increase the annual cash dividend payable to ISG to \$2.0 million.

Edgar Filing: Information Services Group Inc. - Form 10-Q

We anticipate that our current cash and the ongoing cash flows from our operations will be adequate to meet our working capital and capital expenditure needs for at least the next twelve months. The anticipated cash needs of our business could change significantly if we pursue and complete additional business acquisitions, if our business plans change, if economic conditions change from those currently prevailing or from those now anticipated, or if other unexpected circumstances arise that may have a material effect on the cash flow or profitability of our business. If we require additional capital resources to grow our business, either internally or through acquisition, we may seek to sell additional equity securities or to secure debt financing. The sale of additional equity securities or certain forms of debt financing could result in additional dilution to our stockholders. We may not be able to obtain financing arrangements in amounts or on terms acceptable to us in the future.

As of September 30, 2012, the total principal outstanding under the term loan facility was \$58.6 million. There were no borrowings under the revolving credit facility during the three months ended September 30, 2012 or 2011. Additional mandatory principal repayments totaling \$1.8 million and \$10.0 million will be due in 2012 and 2013 respectively with the remaining principal repayments due in 2014. The final mandatory term loan principal repayment will be due on November 16, 2014, which is the maturity date for the term loan.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets or any obligation arising out of a material variable interest in an unconsolidated entity.

Recently Issued Accounting Pronouncements

See Note 3 to our condensed consolidated financial statements included elsewhere in this report.

Critical Accounting Policies and Accounting Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements. We prepare these financial statements in conformity with U.S. generally accepted accounting principles. As such, we are required to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. We base our estimates on historical experience, available information and various other assumptions we believe to be reasonable under the circumstances. On an on-going basis, we evaluate our estimates; however, actual results may differ from these estimates under different assumptions or conditions. There have been no material changes or developments in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our Form 10-K, for the year ended December 31, 2011.

Goodwill

Our goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired at the date of acquisition.

During the third quarter of 2012, management determined that a triggering event had occurred due to a revision in forecasted earnings as a result of macro-economic environment in Europe and continued unfavorable currency translation. Accordingly, the Company evaluated the carrying value of goodwill.

We performed a two-step impairment test on goodwill. Step one compares the fair value of the reporting unit to its carrying amount, including goodwill. If the carrying value of the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test whereby the carrying value of the reporting unit's goodwill is compared to its implied fair value. If the carrying value of the goodwill exceeds the implied fair value, an impairment loss equal to the difference is recorded.

Edgar Filing: Information Services Group Inc. - Form 10-Q

In performing the first step of the impairment test on goodwill, we determined the fair value of the reporting unit using both a market and income approach. The income approach utilizes a discounted cash flow model and is based on projections of future operations of the reporting unit as of the valuation date. The market approach is based on the guideline public company method which considers multiples of comparable companies. The Company selected an amount in the first quartile of such comparable companies. The discounted cash flow model assumed revenue growth rates of approximately 3% per year. We employed a rate of 13% to discount future excess cash flows. As a result of the step one test performed, the fair value of our reporting unit exceeded the carrying value. Accordingly, step two was not performed or required.

Future downturns in our business, continued deterioration of economic conditions, or our stock trading below book value per share may result in an impairment charge in future periods, which could adversely affect our results of operations for those periods.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to financial market risks primarily related to changes in interest rates. A 100 basis point change in interest rates would result in an annual change in the results of operations of \$0.6 million pre-tax.

We operate in a number of international areas which exposes us to significant foreign currency exchange rate risk. We have significant international revenue, which is generally collected in local currency. As of September 30, 2012, the Company had no outstanding forward exchange contracts or other derivative instruments for hedging or speculative purposes. The percentage of total revenues generated outside the Americas increased from 22% in 2004 to 53% in 2011. It is expected that our international revenues will continue to grow in the longer term as European, Asian and other markets adopt sourcing solutions. We recorded a foreign exchange transaction loss of \$0.1 million for the nine months ended September 30, 2012. The translation of our revenues into U.S. dollars, as well as our costs of operating internationally, may adversely affect our business, results of operations and financial condition.

We have not invested in foreign operations in highly inflationary economies; however, we may do so in future periods.

Concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. All cash and cash equivalents are on deposit in fully liquid form in high quality financial institutions. We extend credit to our clients based on an evaluation of each client's financial condition.

Our 20 largest clients accounted for approximately 33% and 45% of revenues for the years ended December 31, 2011 and 2010, respectively. In addition, our large clients generally maintain sizable receivable balances at any given time and our ability to collect such receivables could be jeopardized if such client fails to remain a viable business.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2012, as required by the Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2012.

Internal Control Over Financial Reporting

There have not been any changes in the our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

None.

ITEM 1A. RISK FACTORS

The risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 have not materially changed.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

The following table details the repurchases that were made during the three months ended September 30, 2012.

Period	Total Number of Securities Purchased (In thousands)	Average Price per Securities	Total Numbers of Securities Purchased as Part of Publicly Announced Plan (In thousands)	Approximate Dollar Value of Securities That May Yet Be Purchased Under The Plan (In thousands)
July 1 July 31	105 shares	\$ 1.31	105	\$ 7,846
August 1 August 31	54 shares	\$ 1.26	54	\$ 7,778
September 1 September 30	58 shares	\$ 1.25	58	\$ 7,705

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report:

Exhibit Number	Description
31.1	* Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).
31.2	* Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).
32.1	* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	*

Edgar Filing: Information Services Group Inc. - Form 10-Q

The following materials from ISG's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Condensed Statements of Operations for the three and nine months ended September 30, 2012 and 2011, (ii) the Consolidated Condensed Balance Sheets at September 30, 2012 and December 31, 2011, (iii) Consolidated Condensed Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, and (iv) Notes to Consolidated Condensed Financial Statements for the nine months ended September 30, 2012. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

* Filed herewith.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INFORMATION SERVICES GROUP, INC.

Date: November 9, 2012

/s/ Michael P. Connors
Michael P. Connors, Chairman of the
Board and Chief Executive Officer

Date: November 9, 2012

/s/ David E. Berger
David E. Berger, Executive Vice

President and Chief Financial Officer