

INNODATA ISOGEN INC
Form 10-Q
November 02, 2011

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, 2011

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: 0-22196

INNODATA ISOGEN, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

13-3475943
(I.R.S. Employer
Identification No.)

Three University Plaza
Hackensack, New Jersey
(Address of principal executive offices)

07601
(Zip Code)

(201) 371-8000
(Registrant's telephone number, including area code)

[None]

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of outstanding shares of the registrant’s common stock, \$.01 par value, as of October 21, 2011 was 24,691,000.

INNODATA ISOGEN, INC. AND SUBSIDIARIES
For the Quarter Ended September 30, 2011

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INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share data)

| | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 12,757 | \$ 14,120 |
| Short term investments - other | 8,172 | 8,875 |
| Accounts receivable, net | 12,621 | 8,389 |
| Prepaid expenses and other current assets | 3,888 | 3,842 |
| Deferred income taxes | 1,544 | 1,581 |
| Total current assets | 38,982 | 36,807 |
| Property and equipment, net | 5,108 | 4,284 |
| Other assets | 3,452 | 2,684 |
| Long term investments – other | 3,288 | 5,000 |
| Deferred income taxes | 3,355 | 2,797 |
| Goodwill | 675 | 675 |
| Total assets | \$ 54,860 | \$ 52,247 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,012 | \$ 855 |
| Accrued expenses | 3,060 | 2,192 |
| Accrued salaries, wages and related benefits | 5,967 | 4,870 |
| Income and other taxes | 2,210 | 1,852 |
| Current portion of long term obligations | 632 | 458 |
| Deferred income taxes | 9 | 492 |
| Total current liabilities | 12,890 | 10,719 |
| Deferred income taxes | 153 | 137 |
| Income and other taxes – long term | - | 349 |
| Long term obligations | 2,829 | 1,604 |
| Commitments and contingencies | | |
| Non-controlling interests | (241) | - |
| STOCKHOLDERS' EQUITY: | | |
| Serial preferred stock, 5,000,000 shares authorized, none outstanding | - | - |
| Common stock, \$.01 par value; 75,000,000 shares authorized; 26,237,000 shares issued and 24,691,000 outstanding at September 30, 2011; and 26,207,000 shares issued and 25,155,000 outstanding at December 31, 2010 | 262 | 262 |
| Additional paid-in capital | 21,057 | 20,523 |
| Retained earnings | 22,610 | 20,412 |
| Accumulated other comprehensive income (loss) | (412) | 1,202 |

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| | | |
|---|---------------|---------------|
| | 43,517 | 42,399 |
| Less: treasury stock, 1,546,000 shares at September 30, 2011 and 1,052,000 shares at December 31, 2010, at cost | (4,288) | (2,961) |
| Total stockholders' equity | 39,229 | 39,438 |
| Total liabilities and stockholders' equity | \$ 54,860 | \$ 52,247 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

| | Three Months Ended September 30, | |
|--|-------------------------------------|----------|
| | 2011 | 2010 |
| Revenues | \$19,245 | \$15,763 |
| Operating costs and expenses: | | |
| Direct operating costs | 12,831 | 11,272 |
| Selling and administrative expenses | 4,639 | 4,018 |
| Interest income, net | (175) | (49) |
| Totals | 17,295 | 15,241 |
| Income before provision for income taxes | 1,950 | 522 |
| Provision for income taxes | 766 | 209 |
| Net income | 1,184 | 313 |
| Loss attributable to non-controlling interests | 192 | - |
| Net income attributable to Innodata Isogen, Inc. and Subsidiaries | \$1,376 | \$313 |
| Income per share attributable to Innodata Isogen, Inc. and Subsidiaries: | | |
| Basic and diluted | \$.06 | \$.01 |
| Weighted average shares outstanding: | | |
| Basic | 24,707 | 25,400 |
| Diluted | 25,104 | 25,582 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2011 | 2010 |
| Revenues | \$50,203 | \$46,623 |
| Operating costs and expenses: | | |
| Direct operating costs | 34,874 | 35,651 |
| Selling and administrative expenses | 12,763 | 11,923 |
| Interest income, net | (454) | (84) |
| Totals | 47,183 | 47,490 |
| Income (loss) before provision for income taxes | 3,020 | (867) |
| Provision for income taxes | 1,063 | 1,098 |
| Net income (loss) | 1,957 | (1,965) |
| Loss attributable to non-controlling interests | 241 | - |
| Net income (loss) attributable to Innodata Isogen, Inc. and Subsidiaries | \$2,198 | \$(1,965) |
| Income (loss) per share attributable to Innodata Isogen, Inc. and Subsidiaries: | | |
| Basic and diluted | \$.09 | \$(.08) |
| Weighted average shares outstanding: | | |
| Basic | 24,932 | 25,400 |
| Diluted | 25,141 | 25,400 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2011 | 2010 |
| Cash flow from operating activities: | | |
| Net income (loss) | \$1,957 | \$(1,965) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,334 | 2,832 |
| Stock-based compensation | 534 | 175 |
| Excess tax benefit from stock-based compensation | - | (312) |
| Deferred income taxes | (403) | 44 |
| Pension cost | 322 | 326 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,232) | 2,065 |
| Prepaid expenses and other current assets | (544) | 6 |
| Other assets | (206) | (457) |
| Accounts payable and accrued expenses | 15 | (115) |
| Accrued salaries, wages and related benefits | 1,097 | 788 |
| Income and other taxes | 9 | 777 |
| Net cash provided by operating activities | 883 | 4,164 |
| Cash flow from investing activities: | | |
| Capital expenditures | (2,828) | (1,439) |
| Sale (purchase) of investments - other | 2,415 | (11,668) |
| Net cash used in investing activities | (413) | (13,107) |
| Cash flow used in financing activities: | | |
| Payment of long term obligations | (506) | (539) |
| Excess tax benefit from stock-based compensation | - | 312 |
| Purchase of treasury stock | (1,327) | (393) |
| Net cash used in financing activities | (1,833) | (620) |
| Decrease in cash and cash equivalents | (1,363) | (9,563) |
| Cash and cash equivalents, beginning of period | 14,120 | 26,480 |
| Cash and cash equivalents, end of period | \$12,757 | \$16,917 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for income taxes | \$657 | \$281 |
| Vendor financed software licenses acquired | \$1,325 | \$- |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)
(In thousands)

| | Common Shares | Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|--|------------------|-----------------|----------------------------------|----------------------|--|-------------------|----------|
| January 1, 2011 | 25,155 | \$262 | \$ 20,523 | \$20,412 | \$ 1,202 | \$(2,961) | \$39,438 |
| Net income | - | - | - | 2,198 | - | - | 2,198 |
| Stock-based compensation | 30 | - | 534 | - | - | - | 534 |
| Pension liability adjustments, net of taxes | - | - | - | - | 18 | - | 18 |
| Change in fair value of derivatives, net of taxes | - | - | - | - | (1,632) | - | (1,632) |
| Purchase of treasury stock | (494) | - | - | - | - | (1,327) | (1,327) |
| September 30, 2011 | 24,691 | \$262 | \$ 21,057 | \$22,610 | \$ (412) | \$(4,288) | \$39,229 |
| January 1, 2010 | 25,379 | \$262 | \$ 20,267 | \$21,159 | \$ 1,486 | \$(2,189) | \$40,985 |
| Net loss | - | - | - | (1,965) | - | - | (1,965) |
| Stock-based compensation | 40 | - | 175 | - | - | - | 175 |
| Excess tax benefit from stock-based compensation | - | - | 312 | - | - | - | 312 |
| Pension liability adjustments, net of taxes | - | - | - | - | (9) | - | (9) |
| Change in fair value of derivatives, net of taxes | - | - | - | - | (138) | - | (138) |
| Purchase of treasury stock | (138) | - | - | - | - | (393) | (393) |
| September 30, 2010 | 25,281 | \$262 | \$ 20,754 | \$19,194 | \$ 1,339 | \$(2,582) | \$38,967 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business-Innodata Isogen, Inc. and subsidiaries (the “Company”) provide services, products and solutions that our customers use to create, manage, use and distribute digital information. Our customers include leading media, publishing and information services companies, as well as enterprises that are prominent in information technology, manufacturing, aerospace, defense, financial services, government, healthcare and law.

The Company operates in two reporting segments.

The Company’s Content Services (CS) segment provides business process, technology and consulting services to assist customers in creating, managing, using and distributing digital content.

In the second quarter of 2011, the Company launched Innodata Advanced Data Solutions (IADS) as a separate segment to perform advanced data analysis. IADS operates through two divisions. The Synodex division of IADS offers a range of data analysis services in the healthcare, medical and insurance areas. The docGenix division of IADS provides software products and services that facilitate the generation and analysis of standardized and non-standardized documents for swaps, derivatives, repos, securities lending, prime brokerage, investment management and clearing. The Synodex division is a limited liability company that is 77% owned by the Company. The docGenix division of IADS is a limited liability company that is 78% owned by the Company. The Company purchased certain assets for the docGenix division from a third party for \$0.4 million. The divisions are at an early stage of development and reported no revenues in 2011.

Basis of Presentation-The condensed consolidated financial statements for the interim periods included herein are unaudited; however, they contain all adjustments (consisting of only normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company as of September 30, 2011, and the results of its operations, cash flows and stockholders’ equity for the periods ended September 30, 2011 and 2010. The results of operations for the interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K. Unless otherwise noted, the accounting policies used in preparing these condensed consolidated financial statements are the same as those described in the December 31, 2010 consolidated financial statements.

Principles of Consolidation-The condensed consolidated financial statements include the accounts of Innodata Isogen, Inc., its wholly-owned subsidiaries and the Synodex and docGenix limited liability companies that are majority-owned by the Company. The non-controlling interests in the Synodex and docGenix limited liability companies are accounted in accordance with the non-controlling interest guidance. All significant intercompany transactions and balances have been eliminated in consolidation.

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

estimates. Significant estimates include those related to revenue recognition, allowance for doubtful accounts and billing adjustments, long-lived assets, goodwill, valuation of deferred tax assets, valuation of securities underlying stock-based compensation, litigation accruals, pension benefits, valuation of derivative instruments and estimated accruals for various tax exposures.

INNODATA ISOGEN, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
 (Unaudited)

Recent Accounting Pronouncements-In June 2011, the Financial Accounting Standard Board (FASB) issued a standard regarding the presentation of other comprehensive income (OCI). The new guidance eliminates the option of presenting OCI in the statement of changes in equity, and requires the Company to report items of OCI in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company will adopt the guidance as required. The adoption of this guidance is not expected to have any impact on the Company's condensed consolidated financial statements.

In September 2011, the FASB issued an update on the testing of goodwill impairment. The revised standard provides companies with the option of performing a "qualitative" assessment to determine whether further impairment testing is necessary. An entity can choose to perform the qualitative assessment on none, some, or all of its reporting units, or can bypass the qualitative assessment for any reporting unit in any period and proceed directly to step one of the impairment test. The standard is effective for fiscal years beginning after December 15, 2011, however early adoption is permitted. The Company adopted the guidance early and performed a qualitative assessment. The adoption of this guidance did not have any impact on the Company's condensed consolidated financial statements.

2. Income taxes

The Company had unrecognized tax benefits of approximately \$1.9 million and \$1.8 million at September 30, 2011 and December 31, 2010, respectively. The portion of unrecognized tax benefits relating to interest and penalties was approximately \$0.5 million at both September 30, 2011 and December 31, 2010. The unrecognized tax benefits as of September 30, 2011 and December 31, 2010, if recognized, would have an impact on the Company's effective tax rate.

The following presents a roll-forward of the Company's unrecognized tax benefits and associated interest for the nine months ended September 30, 2011 (amounts in thousands):

| | Unrecognized tax benefits |
|------------------------------|------------------------------|
| Balance - January 1, 2011 | \$ 1,827 |
| Interest accrual | 72 |
| Balance - September 30, 2011 | \$ 1,899 |

The Company is subject to U.S. Federal income tax, as well as income tax in various states and foreign jurisdictions. The Company is no longer subject to examination by Federal and New Jersey taxing authorities for years prior to 2006. Various foreign subsidiaries currently have open tax years ranging from 2004 through 2010.

INNODATA ISOGEN, INC. AND SUBSIDIARIES
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NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

Pursuant to an income tax audit by the Indian Bureau of Taxation in March 2006, one of the Company's Indian subsidiaries received a tax assessment approximating \$339,000, including interest, through September 30, 2011, for the fiscal tax year ended March 31, 2003. Management disagreed with the basis of the tax assessment and filed an appeal with the Appeal Officer against the assessment. In October 2010, the matter was resolved with a judgment in the Company's favor. Under the Indian Income Tax Act, however, the income tax assessing officer has a right to appeal against the judgment passed by the Appeal Officer. In December 2010, the income tax assessing officer exercised this right, against which the Company has filed an application to defend the case, and the Company intends to contest it vigorously. The Indian Bureau of Taxation has also completed an audit of the Company's Indian subsidiary's income tax return for the fiscal tax year ended March 31, 2004. The ultimate outcome was favorable, and there was no tax assessment imposed for the fiscal tax year ended March 31, 2004. As of December 31, 2008 and 2009, the Indian subsidiary received a final tax assessment for the fiscal years ended March 31, 2005 and 2006 from the Indian Bureau of Taxation approximating \$340,000 and \$338,000, respectively, including interest through September 30, 2011. Management disagreed with the basis of these tax assessments, and filed an appeal against them. In October 2010, the matter was resolved with a judgment in the Company's favor for the fiscal year ended March 31, 2005; however, the income tax assessing officer has a right to appeal against the judgment passed by the Appeal Officer. In March 2011, the income tax assessing officer exercised this right, against which the Company has filed an application to defend the case, and the Company intends to contest it vigorously. As of September 30, 2011, there has been no resolution on the tax matter for the fiscal years ended March 31, 2003, 2005 and 2006. As the Company is continually subject to tax audits by the Indian Bureau of Taxation, the Company assessed the likelihood of an unfavorable assessment for the fiscal years ended March 31, 2007, and subsequent years for this subsidiary, and recorded an additional tax provision amounting to approximately \$882,000 including interest through September 30, 2011. The Indian Bureau of Taxation commenced an audit of this subsidiary's income tax returns for the fiscal years ended March 31, 2008 and 2009. The ultimate outcome cannot be determined at this time.

3. Commitments and contingencies

Line of Credit-The Company has a \$7.0 million line of credit pursuant to which it may borrow up to 80% of eligible accounts receivable. Borrowings under the credit line bear interest at the bank's alternate base rate plus 0.5% or LIBOR plus 2.5%. The line, which expires in June 2012, is collateralized by the Company's accounts receivable. The Company has no outstanding obligations under this credit line as of September 30, 2011.

Litigation-In 2008, the Supreme Court of the Republic of the Philippines refused to review a decision of the Court of Appeals in Manila against a Philippines subsidiary of the Company that is inactive and has no material assets, and purportedly also against Innodata Isogen, Inc., that orders the reinstatement of certain former employees of the subsidiary to their former positions and also orders the payment of back wages and benefits that aggregate approximately \$7.5 million. Based on consultation with legal counsel, the Company believes that recovery against the Company is unlikely.

The Company is also subject to various legal proceedings and claims which arise in the ordinary course of business.

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

While management currently believes that the ultimate outcome of these proceedings will not have a material adverse effect on the Company's financial position or overall trends in results of operations, litigation is subject to inherent uncertainties. Substantial recovery against the Company in the above referenced Philippines actions could have a material adverse impact on the Company, and unfavorable rulings or recoveries in the other proceedings could have a material adverse impact on the operating results of the period in which the ruling or recovery occurs. In addition, the Company's estimate of the potential impact on the Company's financial position or overall results of operations for the above legal proceedings could change in the future.

4. Stock options

The Company adopted, with stockholder approval, the Innodata Isogen, Inc. 2009 Stock Plan, as amended and restated (the "2009 Plan"). The maximum number of shares of common stock that may be delivered under the 2009 Plan is 2,270,118 shares, less one share for every share that becomes subject to an Option or Stock Appreciation Rights (SAR) granted after March 31, 2011 and two shares for every share that becomes subject to an Award other than an Option or SAR granted after March 31, 2011. If after March 31, 2011 (i) any shares subject to an award or portion of any award under the 2001 and 2002 Stock Option Plans (collectively, the "Prior Plans") that expires or terminates unexercised, becomes unexercisable, or is forfeited, or is otherwise terminated, surrendered or canceled as to any shares without the delivery of shares of Stock or (ii) shares subject to any Award or portion of an Award under the Plan that expires or terminates unexercised, becomes unexercisable, or is forfeited, or is otherwise terminated, surrendered or canceled as to any shares without the delivery of shares of Stock, the applicable shares subject to such award under the Prior Plans or the Award shall thereafter be available for further Awards under the Plan. Shares that become available for Awards shall be added back as (i) one share for each such share subject to an option under the Prior Plans or an Option or SAR under the Plan, and (ii) as two shares for each such share subject to awards other than Options or SAR under the Plan.

A summary of option activity under the Company's stock option plans as of September 30, 2011, and changes during the period then ended, are presented below:

| | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Contractual Term (years) | Remaining Aggregate Intrinsic Value |
|---|------------------|------------------------------------|--|---|
| Outstanding at January 1, 2011 | 2,096,780 | \$ 2.83 | | |
| Granted | 1,505,000 | \$ 2.59 | | |
| Exercised | — | — | | |
| Forfeited/Expired | (183,451) | \$ 2.74 | | |
| Outstanding at September 30, 2011 | 3,418,329 | \$ 2.73 | 5.24 | \$ 1,489,000 |
| Exercisable at September 30, 2011 | 1,738,720 | \$ 2.69 | 3.02 | \$ 971,000 |
| Vested and expected to vest at September 30, 2011 | 3,418,329 | \$ 2.73 | 5.24 | \$ 1,489,000 |

The fair value of stock options is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average fair values of the options granted and weighted average assumptions are as follows:

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

| | Nine months ended September 30, | |
|--|------------------------------------|------------|
| | 2011 | 2010 |
| Weighted average fair value of options granted | \$ 1.61 | \$ 3.04 |
| Risk-free interest rate | 0.95% - 2.83 % | 2.5%-3.2 % |
| Expected life (years) | 5-8 | 8 |
| Expected volatility factor | 68%-74 % | 90 % |
| Expected dividends | None | None |

No options were exercised during the nine months ended September 30, 2011 and 2010.

A summary of restricted shares under the Company's stock option plans as of September 30, 2011, and changes during the period then ended, are presented below:

| | Number of Shares | Weighted-Average Grant Date Fair Value |
|--------------------------------|------------------|---|
| Unvested at January 1, 2011 | 40,000 | \$ 4.39 |
| Granted | 30,000 | \$ 2.59 |
| Vested | (10,000) | \$ 4.39 |
| Forfeited/Expired | — | \$ — |
| Unvested at September 30, 2011 | 60,000 | \$ 3.49 |

The total compensation cost related to non-vested stock awards not yet recognized as of September 30, 2011, totaled approximately \$2.7 million. The weighted-average period over which these costs will be recognized is thirty four months.

The stock-based compensation expense related to the Company's various stock awards was allocated as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|-------------------------------------|----------------------------------|-------|---------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Direct operating costs | \$ 27 | \$ 4 | \$ 45 | \$ 10 |
| Selling and administrative expenses | 245 | 79 | 489 | 165 |
| Total stock-based compensation | \$ 272 | \$ 83 | \$ 534 | \$ 175 |

5. Long term obligations

Total long term obligations as of September 30, 2011 and December 31, 2010 consist of the following (amounts in thousands):

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

| | 2011 | 2010 |
|--|---------|---------|
| Vendor obligations | | |
| Capital lease obligations | \$16 | \$50 |
| Deferred lease payments | 367 | 282 |
| Microsoft license (1) | 855 | - |
| Forward contracts (2) | 275 | - |
| Pension obligations | | |
| Accrued pension liability | 1,948 | 1,730 |
| | 3,461 | 2,062 |
| Less: Current portion of long term obligations | 632 | 458 |
| Total | \$2,829 | \$1,604 |

(1) In April 2011, the Company renewed a vendor agreement to acquire certain additional software licenses and to receive support and subsequent software upgrades on these and other currently owned software licenses through February 2014. Pursuant to this agreement, the Company is obligated to pay approximately \$472,000 annually over the term of the agreement. The total cost, net of deferred interest, was allocated to the following asset accounts in 2011 (in thousands):

| | |
|---|---------|
| Prepaid expenses and other current assets | \$433 |
| Other assets | 867 |
| Property and equipment | 25 |
| | \$1,325 |

(2) Represents fair value of foreign currency forward contracts.

6. Comprehensive income (loss)

The components of comprehensive income (loss) are as follows (in thousands):

| | Three months ended | | Nine months ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Net income (loss) | \$1,376 | \$313 | \$2,198 | \$(1,965) |
| Pension liability adjustment, net of taxes | 4 | (3) | 18 | (9) |
| Unrealized gain (loss) from derivatives, net of taxes | (1,235) | 612 | (1,632) | (138) |
| Comprehensive income (loss) | \$145 | \$922 | \$584 | \$(2,112) |

Accumulated other comprehensive income (loss) as reflected in the condensed consolidated balance sheets consists of pension liability adjustments, net of taxes and changes in fair value of derivatives, net of taxes. The components of accumulated other comprehensive income (loss) as of September 30, 2011, and changes during the period then ended, are presented below (in thousands):

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(Unaudited)

| | Pension Liability Adjustment | Fair value of Derivatives | Accumulated Other Comprehensive Income (Loss) |
|-------------------------------|---------------------------------|------------------------------|--|
| Balance at January 1, 2011 | \$ 379 | \$ 823 | \$ 1,202 |
| Current-period change | 18 | (1,632) | (1,614) |
| Balance at September 30, 2011 | \$ 397 | \$ (809) | \$ (412) |

7. Segment reporting and concentrations

For the three months and nine months ended September 30, 2011, the Company's operations are classified into two reportable segments: Content Services and IADS.

The Content Services segment provides business process, technology and consulting services to assist customers in creating, managing, using and distributing digital content.

In the second quarter of 2011, the Company launched its IADS segment to perform advanced data analysis. IADS operates through two divisions. The Synodex division of IADS offers a range of data analysis services in the healthcare, medical and insurance areas. The docGenix division of IADS provides software products and services that facilitate the generation and analysis of standardized and non-standardized documents for swaps, derivatives, repos, securities lending, prime brokerage, investment management and clearing.

A significant portion of the Company's revenues are generated from its production facilities in the Philippines, India, Sri Lanka and Israel.

Revenues from external customers and segment operating profit, and other reportable segment information are as follows (in thousands):

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(Unaudited)

| | Three months ended September 30, 2011 | Nine months ended September 30, 2011 |
|--|--|---|
| Revenues: | | |
| Content Services | \$ 19,245 | \$ 50,203 |
| IADS | - | - |
| Total consolidated | \$ 19,245 | \$ 50,203 |
| Income before provision for income taxes: | | |
| Content Services | \$ 2,761 | \$ 4,091 |
| IADS | (811) | (1,071) |
| Total consolidated | \$ 1,950 | \$ 3,020 |
| September 30, 2011 | | |
| Total assets: | | |
| Content Services | | \$ 53,834 |
| IADS | | 1,026 |
| Total consolidated | | \$ 54,860 |

The following table summarizes revenues by geographic region (determined based upon customer's domicile) (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------|-------------------------------------|----------|------------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Unites States | \$13,538 | \$11,120 | \$33,923 | \$31,432 |
| United Kingdom | 2,496 | 1,831 | 6,727 | 6,315 |
| The Netherlands | 1,844 | 2,081 | 6,124 | 5,764 |
| Others - principally Europe | 1,367 | 731 | 3,429 | 3,112 |
| | \$19,245 | \$15,763 | \$50,203 | \$46,623 |

Long-lived assets as of September 30, 2011 and December 31, 2010, respectively, by geographic regions are comprised of (in thousands):

| | 2011 | 2010 |
|---------------------------|----------|----------|
| United States | \$ 1,937 | \$ 1,066 |
| Foreign countries: | | |
| Philippines | 2,142 | 2,300 |
| India | 858 | 895 |
| Sri Lanka | 745 | 495 |
| Israel | 101 | 203 |
| Total foreign | 3,846 | 3,893 |
| | \$ 5,783 | \$ 4,959 |

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Three customers generated approximately 44% and 27% of our revenues for the three months ended September 30, 2011 and 2010, respectively. No other customer accounted for 10% or more of revenues in either period. Further, for the three months ended September 30, 2011 and 2010, revenues from non-US customers accounted for 30% and 29%, respectively, of the Company's revenues.

Three customers generated approximately 39% and 26% of our revenues for the nine months ended September 30, 2011 and 2010, respectively. Another customer accounted for less than 10% of revenues for the nine months ended September 30, 2011, and for 11% of our revenues for the nine months ended September 30, 2010. No other customer accounted for 10% or more of revenues in either period. Further, for the nine months ended September 30, 2011 and 2010, revenues from non-US customers accounted for 32% and 34%, respectively, of the Company's revenues.

A significant amount of the Company's revenues is derived from customers in the publishing industry. Accordingly, the Company's accounts receivable generally include significant amounts due from such customers. In addition, as of September 30, 2011, approximately 32% of the Company's accounts receivable were from foreign (principally European) customers and 33% of accounts receivable were due from two customers. As of December 31, 2010, approximately 34% of the Company's accounts receivable were from foreign (principally European) customers and 37% of accounts receivable were due from three customers.

8. Income (loss) per share

| | Three months ended September 30, 2011 | | September 30, 2010 | |
|---|---|--------|-----------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands, except per share amounts) | | | |
| Net income (loss) attributable to Innodata Isogen, Inc and Subsidiaries | \$1,376 | \$313 | \$2,198 | \$(1,965) |
| Weighted average common shares outstanding | 24,707 | 25,400 | 24,932 | 25,400 |
| Dilutive effect of outstanding options | 397 | 182 | 209 | — |
| Adjusted for dilution computation | 25,104 | 25,582 | 25,141 | 25,400 |

Basic income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted income (loss) per share is computed by considering the impact of the potential issuance of common shares, using the treasury stock method, on the weighted average number of shares outstanding. For those securities that are not convertible into a class of common stock, the "two class" method of computing income (loss) per share is used.

Options to purchase 1.2 million shares of common stock and 1.3 million shares of common stock for the three months ended September 30, 2011 and 2010, respectively, were outstanding but not included in the computation of diluted income (loss) per share because the options' exercise price was greater than the average market price of the common shares and, therefore, the effect would have been antidilutive.

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Options to purchase 1.3 million shares of common stock and 0.3 million shares of common stock for the nine months ended September 30, 2011 and 2010, respectively, were outstanding but not included in the computation of diluted income (loss) per share because the options' exercise price was greater than the average market price of the common shares and, therefore, the effect would have been antidilutive. In addition, diluted net loss per share does not include 1.9 million potential common shares derived from the exercise of stock options and for the nine months ended September 30, 2010 because as a result of the Company incurring losses, their effect would have been antidilutive. All options outstanding were included in the computation of diluted income (loss) per share for the nine months ended September 30, 2011, as the exercise price was lower than the average market price.

9. Derivatives

The Company conducts a large portion of its operations in international markets that subject it to foreign currency fluctuations. The most significant foreign currency exposures occur when revenue and associated accounts receivable are collected in one currency and expenses to generate that revenue are incurred in another currency. The Company's primary exchange rate exposure relates to payroll, other payroll costs and operating expenses in the Philippines, India, Sri Lanka and Israel.

To manage its exposure to fluctuations in foreign currency exchange rates, the Company entered into foreign currency forward contracts, authorized under Company policies, with counterparties that were highly rated financial institutions. The Company utilized non-deliverable forward contracts expiring within eighteen months to reduce its foreign currency risk.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company does not hold or issue derivatives for trading purposes. All derivatives are recognized at their fair value and classified based on the instrument's maturity date. The total notional amount for outstanding derivatives as of September 30, 2011 was \$44 million, which is comprised of cash flow hedges denominated in U.S. dollars.

The following table presents the fair value of derivative instruments included within the condensed consolidated balance sheet as of September 30, 2011 and December 31, 2010 (in thousands):

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| | Balance Sheet Location | Asset (Liability) Derivatives Fair Value | |
|--|---|---|----------|
| | | 2011 | 2010 |
| Derivatives designated as hedging instruments: | | | |
| Foreign currency forward contracts | Prepaid expenses and other current assets | \$ - | \$ 1,304 |
| | Accrued Expenses | 1,010 | - |
| | Long term obligations | 275 | - |

The effect of foreign currency forward contracts designated as cash flow hedges on our condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010, respectively, were as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net gain (loss) recognized in OCI (1) | \$(1,371 |) \$1,584 | \$(1,068 |) \$1,594 |
| Net gain reclassified from accumulated OCI into income (2) | \$589 | \$612 | \$1,521 | \$1,812 |
| Net gain (loss) recognized in income (3) | \$— | \$— | \$— | \$— |

- (1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").
(2) Effective portion classified as direct operating costs.
(3) There were no ineffective portions for the periods presented.

10. Financial Instruments

The carrying amounts of financial instruments, including cash and cash equivalents, accounts receivable and accounts payable approximated their fair value as of September 30, 2011 and December 31, 2010, because of the relative short maturity of these instruments.

“Fair Value Measurements and Disclosures” defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The accounting standard establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three levels. The three levels are defined as follows:

- Level 1: Unadjusted quoted price in active market for identical assets and liabilities.
- Level 2: Observable inputs other than those included in Level 1.

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- Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

The following table sets forth the financial assets as of September 30, 2011 and December 31, 2010 that the Company measured at fair value, on a recurring basis by level, within the fair value hierarchy (in thousands). As required by the standard, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

| September 30, 2011 | Level 1 | Level 2 | Level 3 |
|--------------------------|---------|---------|---------|
| Liability | | | |
| Derivatives | \$— | \$1,285 | \$— |
| December 31, 2010 | | | |
| Assets | | | |
| Derivatives | \$— | \$1,304 | \$— |

The Level 2 assets and liabilities contain foreign currency forward contracts. Fair value is determined based on the observable market transactions of spot and forward rates. The fair value of these contracts as of September 30, 2011 is included in accrued expenses and long term obligations, and December 31, 2010 is included in prepaid expenses and other current assets in the accompanying condensed consolidated balance sheets.

11.Strategic Partnerships

In the second quarter of 2011, the Company launched IADS as a separate reportable segment (see Note 7) to perform advanced data analysis. The Synodex division of IADS offers a range of data analysis services in the healthcare, medical and insurance areas. The docGenix division provides software products and services that facilitate the generation and analysis of standardized and non-standardized documents for swaps, derivatives, repos, securities lending, prime brokerage, investment management and clearing.

The Synodex division of IADS is a limited liability company that is 77% owned by the Company. The docGenix division of IADS is a limited liability company that is 78% owned by the Company. The non-controlling interests in the Synodex and docGenix limited liabilities companies are accounted for by the cost method. The Company purchased certain assets for the docGenix division from a third party for \$0.4 million.

The Company has entered into an operating agreement with the non-controlling interests in the Synodex division and into a separate operating agreement with the non-controlling interest in the docGenix division. Pursuant to these agreements, the Company has a call option to buy the interest of the non-controlling holders at determinable dates and determinable prices. Pursuant to the agreements, the non-controlling interest holders have a put option to sell their interests to the Company at determinable dates and determinable prices. In accordance with the relevant accounting literature, the non-controlling interests are presented as temporary equity in the accompanying condensed consolidated financial statements. In addition, the economic characteristics of the call and put options are similar to the host contract and thus, the put and call options are not freestanding instruments and do not qualify for separate accounting.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Disclosures in this Form 10-Q contain certain forward-looking statements, including without limitation, statements concerning our operations, economic performance, and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words “estimate,” “believe,” “expect,” “anticipate,” “intend” and other similar expressions generally identify forward-looking statements, which speak only as of their dates.

These forward-looking statements are based largely on our current expectations, and are subject to a number of risks and uncertainties, including without limitation, that our IADS segment has not reported any revenues to date and is subject to the risks and uncertainties of early-stage companies; the primarily at-will nature of the contracts between our Content Services segment and its customers and the ability of customers to reduce, delay or cancel projects; continuing Content Services revenue concentration in a limited number of customers; continuing Content Services reliance on project-based work; inability to replace projects that are completed, cancelled or reduced; depressed market conditions; changes in external market factors; the ability and willingness of our customers and prospective customers to execute business plans which give rise to requirements for digital content and professional services in knowledge processing; difficulty in integrating and deriving synergies from acquisitions, joint venture and strategic investments; potential undiscovered liabilities of companies that we acquire; changes in our business or growth strategy; the emergence of new or growing competitors; various other competitive and technological factors; and other risks and uncertainties indicated from time to time in our filings with the Securities and Exchange Commission.

Our actual results could differ materially from the results referred to in the forward-looking statements. In light of these risks and uncertainties, there can be no assurance that the results referred to in the forward-looking statements contained in this Form 10-Q will occur.

We undertake no obligation to update or review any guidance or other forward-looking information, whether as a result of new information, future developments or otherwise.

Business Overview

We provide services, products and solutions that our customers use to create, manage, use and distribute digital information. Our customers include leading media, publishing and information services companies, as well as enterprises that are prominent in information technology, manufacturing, aerospace, defense, financial services, government, healthcare and law.

We operate in two reporting segments.

Our Content Services (CS) segment provides business process, technology and consulting services to assist customers in managing digital content. Most of our customers are in the process of transforming from print publishing to online publishing; from search-based information products to workflow-based information products; or from web-based distribution to multiple-channel distribution that includes mobile, tablet and eReading devices. These transformations require the adoption of new strategies, technologies and processes. We help our customers set digital content production and product strategies; integrate new technologies and processes; and improve the quality and efficiency of content creation, enrichment and transformation. Our customers include legal and business information providers as well as scientific, technical and medical publishers; enterprises that create and manage large volumes of product support content; governmental agencies that manage large volumes of content in support of mission; and retail digital content distribution platforms.

In the second quarter of 2011, we launched Innodata Advanced Data Solutions (IADS) as a separate segment to perform advanced data analysis. IADS operates through two divisions. The Synodex division of IADS offers a range of data analysis services in the healthcare, medical and insurance areas. The docGenix division of IADS provides software products and services that facilitate the generation and analysis of standardized and non-standardized documents for swaps, derivatives, repos, securities lending, prime brokerage, investment management and clearing. We presently own 77% of the Synodex division, a limited liability company, and 78% of the docGenix division, a limited liability company. We purchased certain assets of the docGenix division from a third party for \$0.4 million. The divisions are at an early stage of development, and reported no revenues in 2011.

Each of our segments is organized and managed around three vectors: a vertical industry focus, a horizontal service/process focus, and a supportive operations focus.

The vertically-aligned groups understand our customers' businesses and strategic initiatives. The vertical group for each particular industry includes experts hired from that industry.

Our service/process-aligned groups are comprised of engineering personnel responsible for creating secure and efficient custom workflows and integrating proprietary and third-party technologies, and globally-distributed delivery personnel responsible for executing our customer engagements in accordance with service-level agreements. We deliver services from facilities in the United States, India, the Philippines, Sri Lanka and Israel.

Our support groups are responsible for managing a diverse group of enabling functions that include human resources, recruiting, network and communications technology infrastructure and physical infrastructure and facilities.

Our sales staff, program managers and consultants operate primarily from our North American offices, European locations, as well as from customer sites.

Revenues

We price our business process services based on the quantity delivered or resources utilized and generally recognize revenue in the period in which the services are performed and delivered. A substantial majority of our technology and consulting services are provided on a project basis that generates non-recurring revenues. We price our technology and consulting services on an hourly basis for actual time and expense incurred, or on a fixed-fee, turn-key basis. Revenues for contracts billed on a time-and-materials basis are recognized as services are performed. Revenues under fixed-fee contracts, which are not significant to the overall revenues, are recognized on a percentage-of-completion method of accounting as services are performed or milestones are achieved.

We consider the criteria of reporting revenue gross as a principal versus net as an agent. Factors considered in determining whether we are the principal in the transaction include whether we are the primary obligor, have risks and rewards of ownership, and bear the risk that the customer may not pay for the services performed. If there are circumstances where the above criteria are not met and therefore we are not the principal in providing services, amounts received from customers are presented net of payments in the condensed consolidated statement of operations.

Revenues include reimbursement of out-of-pocket expenses, with the corresponding out-of-pocket expenses included in direct operating costs.

Direct Operating Costs

Direct operating costs consist of direct payroll, occupancy costs, depreciation and amortization, travel, telecommunications, computer services and supplies, and other direct expenses that are incurred in providing services to our customers.

Selling and Administrative Expenses

Selling and administrative expenses consist of management and administrative salaries, sales and marketing costs, new services research and related software development, professional fees and consultant costs, and other administrative overhead costs.

Results of Operations

Three Months Ended September 30, 2011 and 2010

Revenues

Revenues were \$19.2 million for the three months ended September 30, 2011 compared to \$15.8 million for the similar period in 2010, an increase of approximately \$3.5 million or 22%. The increase in revenues is principally attributable to one of our top three customers. Revenues in the 2011 period reflect a \$4.0 million increase over the 2010 period in revenues from our top three customers, partially offset by a net decline in revenue from other customers.

Our top three customers generated \$8.4 million or 44% of revenues for the three months ended September 30, 2011 compared to \$4.4 million or 27% of revenues for the three months ended September 30, 2010. No other customer accounted for 10% or more of our total revenues in either period.

Further, revenues from customers located in foreign countries (principally in Europe) amounted to \$5.7 million or 30% and \$4.6 million or 29% of our total revenues for the three months ended September 30, 2011 and 2010, respectively.

There were no revenues for the three months ended September 30, 2011 from our recently formed IADS segment.

Direct Operating Costs

Direct operating costs were \$12.8 million and \$11.3 million for the three months ended September 30, 2011 and 2010, respectively, an increase of approximately \$1.6 million or 14%.

The increase in direct operating costs was attributable to an increase in production headcount and other operating costs in support of increased revenues. In addition, direct operating costs increased on account of foreign exchange rate fluctuations caused by a strengthening of the Philippine peso and Indian rupee against the U.S. dollar. The increase in direct operating costs was partially offset by a decrease in direct labor costs achieved primarily from productivity gains. The productivity gains were principally the result of increased efficiency, improvements in our processes and innovation in our technology.

Included in total direct operating costs is approximately \$0.3 million in start-up costs that we incurred for the IADS segment during the three months ended September 30, 2011.

The changes in revenues and direct operating expenses mentioned above resulted in a decline in direct operating costs as a percentage of revenues to 67% for the three months ended September 30, 2011, from 72% for the three months ended September 30, 2010.

Selling and Administrative Expenses

Selling and administrative expenses were \$4.6 million and \$4.0 million for the three months ended September 30, 2011 and 2010, respectively, an increase of approximately \$0.6 million or 15%.

The increase in selling and administrative costs is primarily due to an increase in compensation costs of new personnel hired for sales, and other administrative costs, including approximately \$0.5 million, incurred for the IADS segment, which were partially offset by routine cost efficiencies and approximately \$0.1 million from the recovery of a previously fully reserved account receivable.

Selling and administrative expenses as a percentage of revenues were 24% for the three months ended September 30, 2011 compared to 25% for the three months ended September 30, 2010.

Income Taxes

For the three months ended September 30, 2011, we recorded a provision for income taxes for the U.S. entity and certain but not all of our foreign subsidiaries, as certain foreign subsidiaries are subject to tax holidays or preferential tax rates. In addition, certain overseas income is not subject to tax in the U.S. unless repatriated.

For the three months ended September 30, 2010, the provision for income taxes was primarily comprised of the provision we recorded for the U.S. Parent and certain of our foreign subsidiaries. In addition, the provision for income tax also includes the provision we recorded for one of our Indian subsidiaries for uncertain tax positions. As this subsidiary has been continually subject to tax audits by the Indian Bureau of Taxation, we assessed the likelihood of an unfavorable assessment for the three months ended September 30, 2010 and recorded a provision of \$60,000. Certain overseas income is not subject to tax in the U.S. unless repatriated.

Net Income

We generated net income of \$1.3 million in the three months ended September 30, 2011 compared to \$0.3 million in the three months ended September 30, 2010. The change was primarily attributable to an increase in gross margins resulting from an increase in revenues and an increase in productivity, due to improvements in processes and technology, partially offset by unfavorable foreign exchange rates and start-up costs incurred for the IADS segment.

Nine Months Ended September 30, 2011 and 2010

Revenues

Revenues were approximately \$50.2 million for the nine months ended September 30, 2011, compared to \$46.6 million for the similar period in 2010, an increase of \$3.6 million or 8%. The increase in revenues is principally attributable to one of our top three customers. Revenues in the 2011 period reflect a \$7.4 million increase over the 2010 period in revenues from our top three customers and a one-time fee of \$0.6 million for early termination of an engagement, partially offset by a net decline in revenue from other customers.

Our top three customers generated \$19.6 million or 39% for the nine months ended September 30, 2011 compared to \$12.2 million or 26% of revenues for the nine months ended September 30, 2010. Another customer accounted for less than 10% of our revenues for the nine months ended September 30, 2011, and for \$5.3 million or 11% of our revenues for the nine months ended September 30, 2010. No other customer accounted for 10% or more of our total revenues in either period.

Further, revenues from customers located in foreign countries (principally in Europe) amounted to \$16.3 million or 32% and \$15.2 million or 33% of our total revenues for the nine months ended September 30, 2011 and 2010, respectively.

There were no revenues for the nine months ended September 30, 2011 from our recently formed IADS segment.

Direct Operating Costs

Direct operating costs were \$34.9 million and \$35.7 million for the nine months ended September 30, 2011 and 2010, respectively, a decline of approximately \$0.8 million or 2%.

The decrease in direct operating costs was attributable to a decrease in labor costs achieved primarily from productivity gains. The productivity gains were principally the result of increased efficiency, improvements in our processes and innovation in our technology. These declines partially offset an increase in direct operating costs attributable to an increase in production headcount and other operating costs in support of increased revenues, and unfavorable foreign exchange rate fluctuations caused by a strengthening of the Philippine peso and Indian rupee against the U.S. dollar.

Included in total direct operating costs is approximately \$0.4 million in start-up costs that we incurred for the IADS segment.

The changes in direct operating expenses mentioned above resulted in a decline of direct operating costs as a percentage of revenues to 69% for the nine months ended September 30, 2011 from 76% for the nine months ended September 30, 2010.

Selling and Administrative Expenses

Selling and administrative expenses were \$12.8 million and \$12.0 million for the nine months ended September 30, 2011 and 2010, respectively, an increase of approximately \$0.8 million or 7%.

The increase in selling and administrative expenses for the nine months ended September 30, 2011 is principally attributable to compensation costs of new personnel hired for sales, severance costs of \$0.3 million, and increases in miscellaneous administrative costs including approximately \$0.7 million incurred for the IADS segment. These increases were partially offset by the recovery of approximately \$0.6 million from a previously fully reserved account receivable.

As a percentage of revenue, selling and administrative costs remained at 26% for the nine months ended September 30, 2011 and 2010.

Income Taxes

For the nine months ended September 30, 2011, we recorded a provision for income taxes for the U.S. entity and certain, but not all of our foreign subsidiaries, as certain foreign subsidiaries are subject to tax holidays or preferential

tax rates. In addition, certain overseas income is not subject to tax in the U.S. unless repatriated.

For the nine months ended September 30, 2010, the provision for income taxes was primarily comprised of the provision we recorded for one of our Indian subsidiaries for uncertain tax positions. As this subsidiary has been continually subject to tax audits by the Indian Bureau of Taxation, we assessed the likelihood of an unfavorable assessment for the fiscal year ended March 31, 2010 and for the nine months ended September 30, 2010, and recorded a provision of \$420,000. In addition, the provision for income taxes also includes the provision we recorded for the U.S. Parent and certain of our foreign subsidiaries. Certain overseas income is not subject to tax in the U.S. unless repatriated.

Net Income (Loss)

We generated net income of \$2.1 million in the nine months ended September 30, 2011 compared to a net loss of \$2.0 million in the nine months ended September 30, 2010. The change was primarily attributable to an increase in gross margins resulting from an increase in revenues, and an increase in productivity due to improvements in processes and technology partly offset by unfavorable foreign exchange rates and start-up costs incurred for the IADS segment. The change in net income also reflects an increase in interest income.

Liquidity and Capital Resources

Selected measures of liquidity and capital resources, expressed in thousands, are as follows:

| | September 30, 2011 | December 31, 2010 |
|--|--------------------|-------------------|
| Cash and cash equivalents | \$ 12,757 | \$ 14,120 |
| Short term and long term investments - other | 11,460 | 13,875 |
| Working capital | 26,092 | 26,088 |

At September 30, 2011, we had cash and cash equivalents of \$12.8 million and short term and long term investments of \$11.5 million. We have used, and plan to use, these funds for (i) expansion of existing operations; (ii) general corporate purposes, including working capital; and (iii) possible business acquisitions. We had working capital of approximately \$26.1 million as of both September 30, 2011 and December 31, 2010. We do not anticipate any near-term liquidity issues.

Net Cash Provided By Operating Activities

Cash provided by our operating activities for the nine months ended September 30, 2011 was \$0.9 million, resulting from net income of \$2.0 million, adjustments for non-cash items of \$2.8 million and \$3.9 million used by working capital changes. Adjustments for non-cash items primarily consisted of \$2.3 million for depreciation and amortization, \$0.5 million for stock-based compensation and \$(0.3) million for deferred income taxes. Working capital activities primarily consisted of a use of cash of \$4.2 million for an increase in accounts receivable, primarily related to an increase in revenue, and a source of cash of \$1.0 million for accounts payable, accrued expenses and accrued salaries, wages and related benefits representing the timing of expenditures and payments.

Cash provided by our operating activities for the nine months ended September 30, 2010 was \$4.2 million, resulting from a net loss of \$2.0 million, adjustments for non-cash items of \$3.1 million and \$3.1 million provided by changes in working capital. Adjustments for non-cash items primarily consisted of \$2.8 million for depreciation and amortization and \$0.3 million for pension costs. Working capital activities primarily consisted of a source of cash of \$2.8 million as a result of net collections of accounts receivable, a source of cash of \$0.8 million for an increase in accrued salaries and wages, primarily on account of accruals and timing of payments, and a source of cash of \$0.8 million related to income and other taxes.

At September 30, 2011, our days' sales outstanding for accounts receivable were approximately 57 days compared to 61 days as of December 31, 2010.

Net Cash Used in Investing Activities

For the nine months ended September 30, 2011, we spent cash approximating \$2.8 million for capital expenditures, compared to approximately \$1.4 million for the nine months ended September 30, 2010. Capital spending in 2011 principally consisted of the purchase of technology equipment including workstations, computer software and leasehold improvements. Also included within capital expenditures are costs incurred to acquire computer software for the IADS segment and to establish two new delivery centers in Asia. Capital spending in 2010 related principally to technology equipment and computer software. During the next twelve months, we anticipate that capital expenditures for ongoing technology, hardware, software, leasehold improvements, fittings, equipment and infrastructure upgrades and establishment of new delivery centers will approximate \$6.0 to \$7.0 million, a portion of which we may finance. Also, included in the investing activities during the nine months ended September 30, 2011 is the sale of short term and long term investments primarily representing proceeds on maturity of certificates of deposit, and during the nine months ended September 30, 2010 is the purchase of short term and long term investments consisting of certificate of deposit amounting to \$11.7 million.

Net Cash Used in Financing Activities

In April 2011, we renewed a vendor agreement, which expired in February 2011, to acquire certain additional software licenses and to receive support and subsequent software upgrades on these and other currently owned software licenses through February 2014, for a total cost of approximately \$1.4 million, representing a non-cash investing and financing activity. During the nine months ended September 30, 2011, we paid \$0.5 million under this agreement. The agreement, which expired in February 2011, was originally entered into in February 2008 for a total cost of approximately \$1.6 million. In conjunction with this agreement, we paid approximately \$0.4 million during the nine months ended September 30, 2010.

Total payments of long term obligations, including the vendor agreement, approximated \$0.5 million for the nine months ended September 30, 2011 and 2010, respectively.

During the nine months ended September 30, 2011, we repurchased 494,000 shares of our common stock at a cost of approximately \$1.3 million, at a volume-weighted average price of \$2.69 per share. During the nine months ended September 30, 2010, we repurchased 138,000 shares of our common stock at a cost of approximately \$0.4 million, at a volume-weighted average price of \$2.82 per share.

Future Liquidity and Capital Resource Requirements

We have a \$7.0 million line of credit pursuant to which we may borrow up to 80% of eligible accounts receivable. Borrowings under the credit line bear interest at the bank's alternate base rate plus 0.5% or LIBOR plus 2.5%. The line, which expires in June 2012, is collateralized by our accounts receivable. We had no outstanding obligations under this credit line as of September 30, 2011.

We believe that our existing cash and cash equivalents, short term and long term investments, funds generated from our operating activities and funds available under our credit facility will provide sufficient sources of liquidity to satisfy our financial needs for the next twelve months. However, if circumstances change, we may need to raise debt or additional equity capital in the future.

Contractual Obligations

The table below summarizes our contractual obligations (in thousands) at September 30, 2011 and the effects that those obligations are expected to have on our liquidity and cash flows in future periods.

| Contractual Obligations | Payments Due by Period | | | | |
|------------------------------------|------------------------|---------------------|-----------|-----------|------------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Capital lease obligations | \$ 16 | \$ 16 | \$- | \$- | \$- |
| Vendor obligations | 942 | 471 | 471 | - | - |
| Non-cancelable operating leases | 6,275 | 1,695 | 3,044 | 1,425 | 111 |
| Total contractual cash obligations | \$7,233 | \$2,182 | \$3,515 | \$1,425 | \$111 |

Future expected obligations under our pension benefit plan have not been included in the contractual cash obligations table above.

Inflation, Seasonality and Prevailing Economic Conditions

Our most significant costs are the salaries and related benefits of our employees in Asia. We are exposed to higher inflation in wage rates in the countries in which we operate. We generally perform work for our customers under project-specific contracts, requirements-based contracts or long-term contracts. We must adequately anticipate wage increases, particularly on our fixed-price contracts. There can be no assurance that we will be able to recover cost increases through increases in the prices that we charge for our services to our customers.

Our quarterly operating results are subject to certain fluctuations. We experience fluctuations in our revenue and earnings as we replace and begin new projects, which may have some normal start-up delays, or we may be unable to replace a project entirely. These and other factors may contribute to fluctuations in our operating results from quarter to quarter. In addition, as some of our Asian facilities are closed during holidays in the fourth quarter, we typically incur higher wages, due to overtime, that reduce our margins.

Critical Accounting Policies and Estimates

Our discussion and analysis of our results of operations, liquidity and capital resources are based on our consolidated financial statements which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparations of these consolidated financial statements require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts and billing adjustments, long-lived assets, goodwill, valuation of deferred tax assets, value of securities underlying stock-based compensation, litigation accruals, pension benefits, valuation of derivative instruments and estimated accruals for various tax exposures. We base our estimates on historical and anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from our estimates and could have a significant adverse effect on our results of operations and financial position. For a discussion of our critical accounting policies see Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to our critical accounting policies during the nine months ended September 30, 2011.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standard Board (FASB) issued a standard regarding the presentation of other comprehensive income (OCI). The new guidance eliminate the option of presenting OCI in the statement of changes in equity, and requires to report items of OCI in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We will adopt the guidance as required. The adoption of this guidance is not expected to have any impact on our condensed consolidated financial statements.

In September 2011, the FASB issued an update on the testing of goodwill impairment. The revised standard provides companies with the option of performing a “qualitative” assessment to determine whether further impairment testing is necessary. An entity can choose to perform the qualitative assessment on none, some, or all of its reporting units or can bypass the qualitative assessment for any reporting unit in any period and proceed directly to step one of the impairment test. The standard is effective for fiscal years beginning after December 15, 2011, however early adoption is permitted. We adopted the guidance early and performed a qualitative assessment. The adoption of this guidance did not have any impact on our condensed consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest rate risk

We are exposed to market risk, due to interest rate fluctuations, with respect to our credit line with a financial institution which is priced based on the bank’s alternate base rate (3.25% at September 30, 2011) plus 0.5% or LIBOR (0.25% at September 30, 2011) plus 2.5%. We have no outstanding obligations under this line. To the extent we utilize all or a portion of this line of credit, changes in the interest rate will have a positive or negative effect on our interest expense.

Foreign currency risk

We have operations in several international markets that subject us to foreign currency fluctuations. Although the majority of our contracts are denominated in U.S. dollars, a substantial portion of the costs incurred to render services under these contracts is incurred in the local currencies of several international markets where we carry on our operations. Our significant operations are based in the Philippines, India, Sri Lanka and Israel where revenues are generated in U.S. dollars and the corresponding expenses are generated in foreign currency.

To mitigate the exposure of fluctuating future cash flows due to changes in foreign exchange rates, we have entered into foreign currency forward contracts. These foreign currency forward contracts were entered into with a maximum term of eighteen months and have an aggregate notional amount of approximately \$44 million as of September 30, 2011. We may continue to enter into such instruments or other instruments in the future to reduce foreign currency exposure to appreciation or depreciation in the value of these foreign currencies.

The impact of foreign currency fluctuations will continue to present economic challenges to us and could negatively impact our overall results of operations. A 10% appreciation in the U.S. dollar's value relative to hedged currencies would decrease the forward contracts' fair value by approximately \$3.6 million as of September 30, 2011. Similarly, a 10% depreciation in the U.S. dollar's value relative to hedged currencies would increase the forward contracts' fair value by approximately \$4.3 million. Any increase or decrease in the fair value of our currency exchange rate sensitive forward contracts, if utilized, would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying cash flows.

Other than the aforementioned forward contracts, we have not engaged in any hedging activities nor have we entered into off-balance sheet transactions or arrangements.

As of September 30, 2011, our foreign locations held cash and short term and long term investments totaling approximately \$16 million.

Item 4. Controls and Procedures

As of the end of the period covered by this report, we performed an evaluation under the supervision, and with the participation, of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)) under the Securities and Exchange Act of 1934 (the Exchange Act)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 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

There were no material changes from the legal proceedings previously disclosed in Part I, Item 3. "Legal Proceedings" in our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 1A. Risk Factors

There were no material changes from the risk factors previously disclosed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We purchased approximately 152,000 shares of our common stock, for a total cost of approximately \$0.4 million, during the three months ended September 30, 2011, as shown in the table below:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Value of Shares Available for Repurchase |
|----------------------|----------------------------------|------------------------------|--|--|
| July 1-31, 2011 | — | — | — | \$ 447,000 |
| August 1-31, 2011 | 125,626 | \$ 2.97 | 125,626 | \$ 74,000 |
| September 1-30, 2011 | 25,946 | \$ 2.84 | 25,946 | \$ - |

In June 2010, we announced that our Board of Directors authorized the repurchase of up to \$2.1 million of our common stock. As of September 30, 2011, we repurchased approximately 758,000 shares of our common stock representing almost the entire June 2010 authorization.

In September 2011, our Board of Directors authorized the repurchase of up to \$2.0 million of our common stock in open market or private transactions. There is no expiration date associated with the program.

There were no sales of unregistered equity securities during the three months ended September 30, 2011.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Reserved

Item 5. Other Information

None.

Item 6. Exhibits

31.1 Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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. INS XBRL Instance Document

101. SCH XBRL Taxonomy Extension Schema Document

101. CAL XBRL Taxonomy Extension Calculation Link base Document

101. DEF XBRL Taxonomy Extension Definition Link base Document

101. LAB XBRL Taxonomy Extension Label Link base Document

101. PRE XBRL Taxonomy Extension Presentation Link base Document

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.

INNODATA ISOGEN, INC.

Date: November 2, 2011

/s/ Jack Abuhoff
Jack Abuhoff
Chairman of the Board,
Chief Executive Officer and President

Date: November 2, 2011

/s/ O'Neil Nalavadi
O'Neil Nalavadi
Senior Vice President
Chief Financial Officer
and Principal Accounting Officer