Information Services Group Inc.
Form 10-Q
August 09, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from to

Commission File Number 001-33287

INFORMATION SERVICES GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**20-5261587**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Two Stamford Plaza
281 Tresser Boulevard
Stamford, CT 06901
(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 x No o

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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). o Yes x 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 July 25, 2011**
Common Stock, $0.001 par value	36,444,735 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 (UNAUDITED)

INFORMATION SERVICES GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par value)

	June 30, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 12,856	$ 40,301
Accounts receivable, net of allowance of $1,107 and $195, respectively	51,839	26,603
Deferred tax asset	3,100	2,852
Prepaid expense and other current assets	2,787	1,281
Total current assets	70,582	71,037
Restricted cash		5,750
Furniture, fixtures and equipment, net	2,877	2,113
Goodwill	69,995	48,474
Intangible assets, net	67,345	55,746
Other assets	1,284	1,444
Total assets	$ 212,083	$ 184,564
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 3,356	$ 1,656
Current maturities of long-term debt	5,500	
Deferred revenue	4,464	1,175
Accrued expenses	16,947	10,701
Total current liabilities	30,267	13,532
Long-term debt, net of current maturities	66,563	69,813
Deferred tax liability	18,486	19,336
Other liabilities	4,861	66
Total liabilities	120,177	102,747
Commitments and contingencies (Note 6)		
Stockholders equity		
Preferred stock, $.001 par value; 10,000 shares authorized; none issued		
	36	33

Common stock, $.001 par value, 100,000 shares authorized; 36,401 shares issued and 36,385 shares outstanding at June 30, 2011 and 32,617 shares issued and 32,601 outstanding at December 31, 2010				
Additional paid-in-capital		203,207		192,989
Treasury stock (16 shares, at cost)		(57)		(57)
Accumulated other comprehensive loss		(327)		(1,553)
Accumulated deficit		(110,953)		(109,595)
Total stockholders equity		91,906		81,817
Total liabilities and stockholders equity	$	212,083	$	184,564

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Revenues	$ 50,253	$ 33,372	$ 90,911	$ 68,216
Operating expenses				
Direct costs and expenses for advisors	27,718	17,779	51,948	36,260
Selling, general and administrative	17,163	12,224	36,067	24,562
Depreciation and amortization	2,859	2,342	5,570	4,701
Operating income (loss)	2,513	1,027	(2,674)	2,693
Interest income	5	51	35	86
Interest expense	(793)	(794)	(1,675)	(1,588)
Foreign currency transaction gain (loss)	163	33	200	(72)
Income (loss) before taxes	1,888	317	(4,114)	1,119
Income tax provision (benefit)	1,201	131	(2,756)	473
Net income (loss)	$ 687	$ 186	$ (1,358)	$ 646
Weighted average shares outstanding:				
Basic	36,376	31,981	36,240	31,951
Diluted	38,379	32,219	36,240	32,176
Earnings (loss) per share:				
Basic	$ 0.02	$ 0.01	$ (0.04)	$ 0.02
Diluted	$ 0.02	$ 0.01	$ (0.04)	$ 0.02

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)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities		
Net (loss) income	$ (1,358)	$ 646
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation expense	729	745
Amortization of intangibles	4,841	3,956
Amortization of deferred financing costs	167	182
Compensation costs related to stock-based awards	1,627	1,677
Bad debt expense	586	50
Deferred tax benefit	(3,837)	(1,898)
(Gain) loss on disposal of furniture, fixtures and equipment	(15)	14
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(13,960)	(1,005)
Prepaid expense and other current assets	585	146
Accounts payable	(970)	(190)
Deferred revenue	453	322
Accrued liabilities	(4,638)	(3,887)
Net cash (used in) provided by operating activities	(15,790)	758
Cash flows from investing activities		
Acquisitions, net of cash acquired	(13,684)	
Restricted cash	5,750	
Proceeds from sale of furniture, fixtures and equipment	20	
Purchase of furniture, fixtures and equipment	(686)	(475)
Net cash used in investing activities	(8,600)	(475)
Cash flows from financing activities		
Principal payments on borrowings	(4,000)	(2,000)
Proceeds from issuance of ESPP shares	137	157
Net cash used in financing activities	(3,863)	(1,843)
Effect of exchange rate changes on cash	808	(780)
Net decrease in cash and cash equivalents	(27,445)	(2,340)
Cash and cash equivalents, beginning of period	40,301	42,786
Cash and cash equivalents, end of period	$ 12,856	$ 40,446
Supplemental disclosures of cash flow information:		
Noncash financing activities:		
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 or ISG) (Nasdaq: III) is a leading technology insights, market intelligence and advisory services company. We support private and public sector clients in transforming and optimizing their operational environments through strategic consulting, benchmarking and analytics, managed services and research with a focus on information technology, business process transformation and enterprise resource planning.

Our company was founded in 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. In 2007, ISG consummated its initial public offering and completed the acquisition of TPI Advisory Services Americas, Inc. (TPI). TPI operates 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.

In the first quarter of 2011, ISG completed the acquisitions of the entire issued share capital CCGH Limited, an English corporation (Compass) and Salvaggio, Teal & Associates (STA Consulting or STA). Including our most recent acquisitions, we now operate in 21 countries and employ nearly 700 professionals globally, delivering advisory, benchmarking and analytical insight to large, multinational corporations and governments in North America, Europe and Asia Pacific. We deliver these services through three go-to market brands: TPI, Compass and STA Consulting.

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. It was founded in 1980 and headquartered in the United Kingdom and has 180 employees in 16 countries serving nearly 250 clients worldwide.

On February 10, 2011 ISG completed the acquisition of STA, 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 and other enterprise administration and management systems. STA 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.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010, 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 June 30, 2011, the results of operations for the three and six months ended June 30, 2011 and 2010 and the cash flows for the six months ended June 30, 2011 and 2010. The condensed consolidated balance sheet as of December 31, 2010 has been derived from the Company s audited consolidated financial statements. Operating results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

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, 2010, which are included in the Company s 2010 Form 10-K filed with the SEC.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Restricted Cash

Restricted cash consists of cash and cash equivalents which the Company has pledged to fulfill certain obligations and are not available for general corporate purposes.

At December 31, 2010 the $5.8 million was held in escrow to satisfy the cash consideration component of the Compass acquisition. This amount was paid in January 2011 and no longer held in escrow.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Derivative Instruments

We may enter into derivative financial transactions to hedge existing or projected transactional exposures due to changing foreign currency exchange rates. We do not enter into derivative transactions for speculative or trading purposes. We recognize all derivative transactions on the balance sheet at fair value which are reflected through the results of operations and included in foreign currency gain (loss) in our condensed consolidated statements of operations. While derivative instruments are subject to fluctuations in value, the fluctuations are generally offset by the value of the underlying transactional exposures being managed. The use of some derivative transactions may limit our ability to benefit from favorable fluctuations in foreign exchange rates. Our derivatives are not designated as hedges for accounting purposes. As of June 30, 2011, we have no outstanding forward exchange contracts or other derivative instruments for hedging or speculative purposes.

Earnings (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 six months ended June 30, 2011, the effect of 5.0 million warrants, 0.4 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, 1.0 million restricted shares have not been considered in the diluted earnings per share calculation for the three and six months ended June 30, 2011, as the effect would be anti-dilutive. For the three and six months ended June 30, 2010, the effect of 35.6 million warrants, 0.5 million SARs and 1.4 million Units (each Unit comprising one common share and one warrant) associated with the Company s IPO underwriters purchase option have not been considered in the diluted earnings per share calculation, since the market price of the Company s common stock was less than the exercise price during the period in the computation. In addition, 0.7 million restricted shares have not been considered in the diluted earnings per share calculation for the three and six months ended June 30, 2010, as the effect would be anti-dilutive.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Basic:				
Net income (loss)	$ 687	$ 186	$ (1,358)	$ 646
Weighted average common shares	36,376	31,981	36,240	31,951

Basic income (loss) per share	$	0.02	$	0.01	$	(0.04)	$	0.02
Diluted:								
Net income (loss)	$	687	$	186	$	(1,358)	$	646
Interest expense of convertible debt, net of tax		22						
Net income (loss), as adjusted	$	709	$	186	$	(1,358)	$	646
Basic weighted average common shares		36,376		31,981		36,240		31,951
Potential common shares		2,003		238				225
Diluted weighted average common shares		38,379		32,219		36,240		32,176
Diluted income (loss) per share	$	0.02	$	0.01	$	(0.04)	$	0.02

Recently Issued Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance that clarifies which debt restructurings are considered troubled debt restructurings. Debt, which includes receivables, restructured in a troubled debt restructuring is classified as impaired for calculation of the allowance for doubtful accounts and is subject to additional

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

disclosures detailing the modifications of the debt. The guidance is effective for interim or annual periods beginning on or after June 15, 2011. The adoption of this standard did not have a material impact on the Company s consolidated financial statements.

In June 2011, the FASB issued accounting guidance related to the presentation of comprehensive income. This guidance presents an entity with the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance relates only to the presentation of comprehensive income. The provisions of this new guidance are effective for fiscal years and interim periods beginning after December 15, 2011 and are applied retrospectively for all periods presented. We do not anticipate the adoption of this guidance to materially impact the Company s consolidated financial statements.

NOTE 4 ACQUISITIONS

Compass Acquisition

On January 4, 2011 (the Compass Acquisition Date), the Company executed an Agreement for the Sale and Purchase of the entire issued share capital of Compass (the Agreement) and consummated the acquisition of the entire issued share capital of Compass.

Under the terms of the Agreement, each of the holders of the issued share capital of Compass agreed to sell and transfer, and the Company agreed to buy, the entire share capital of Compass (the Share Purchase). The Share Purchase was consummated on January 4, 2011.

The total allocable purchase price consists of the following:

Cash	$	5,750
Common Stock*		7,980
Convertible Notes**		6,250
Stamp Tax		98

Total allocable purchase price	$	20,078

* 3,500,000 shares issued at $2.28 per share, the closing stock price of the Company on January 4, 2011.

** The Convertible 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 the Company s 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 the Company s common stock at the rate of 1 share for every $4 in principal amount outstanding. After the Trigger Event, the Company may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

The purchase price has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of the Compass Acquisition Date. The purchase price allocation was based upon a valuation completed by third-party valuation specialists using an income approach and estimates and assumptions provided by management. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. The goodwill recognized is primarily attributable to expected synergies that will result from combining the operations of ISG and Compass as well as intangible assets that do not qualify for separate recognition. Goodwill of $16.6 million acquired in the acquisition is not deductible for tax purposes.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

The following table summarizes the preliminary allocation of the aggregate purchase price to the fair value of the assets acquired and liabilities assumed as of the Compass Acquisition Date:

Allocation of Purchase Price:		
Cash	$	1,091
Accounts receivable		9,449
Prepaid expenses and other assets		2,042
Furniture, fixtures and equipment, net		685
Goodwill		16,566
Intangible assets		5,045
Accounts payable		(1,603)
Accrued expenses and other (1)		(11,280)
Deferred income tax liability		(1,917)
Net assets acquired	$	20,078

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(1) The fair value of contingent liabilities related to uncertain tax positions recognized at the acquisition date is $1.5 million.

The intangible assets acquired include database, trademark and trade name, customer relationships, covenant not-to-compete and goodwill. Some of these assets, such as goodwill and the trademark and trade name are not subject to amortization but rather an annual test for possible impairment; other intangible assets that are amortized over their useful lives are reviewed when events or changes or circumstances indicate the carrying amount of the asset may not be recoverable.

Under the purchase method of accounting, the total purchase price of approximately $20.1 million was allocated to Compass s net tangible and intangible assets based on their estimated fair values as of the Compass Acquisition Date. Intangible assets are amortized utilizing the estimated pattern of the consumption of the economic benefit over their estimated lives, ranging from one to ten weighted average years. Based on the valuation and other factors as described above, the purchase price assigned to intangible assets and the amortization period were as follows:

		Purchase Price Allocation	Asset Life
Amortizable intangible assets:			
Customer relationships	$	1,150	10 years
Covenants not-to-compete		15	2 years
Databases-Financial Data Repository		1,840	7 years
Non-amortizable intangible assets:			
Trademark and trade name		2,040	Indefinite

Total intangible assets	$	5,045

We have not finalized our assessment of the fair values as of the issuance of this Form 10-Q since we have not completed our review of individual contracts, agreements, and accounting records of Compass.

STA Acquisition

On February 10, 2011 (the STA Acquisition Date), the Company executed an Asset Purchase Agreement (the STA Agreement) with Salvaggio & Teal Ltd. (d/b/a Salvaggio, Teal & Associates, STA), Salvaggio & Teal II, LLC, Mitt Salvaggio, Kirk Teal, Nathan Frey and International Consulting Acquisition Corp., a wholly-owned subsidiary of ISG, and consummated the acquisition of substantially all of the assets and assumption of certain specified liabilities of STA (collectively, the Asset Purchase).

Under the terms of the STA Agreement, ISG acquired the specified assets for cash consideration of $9.0 million subject to certain adjustments. In addition, the sellers under the Agreement (the STA Sellers) are eligible to receive a minimum of $0 and a maximum up to $7.75 million of earn-out payments for fiscal years 2011-2015 if certain revenue and earnings targets are met. Finally, the STA Sellers were granted 250,000 restricted shares of ISG common stock (the ISG Restricted Shares) that will vest if the commercial enterprise resource planning revenue of ISG and its affiliates are met.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

As of the STA Acquisition Date, we have recorded a liability of $6.7 million representing the fair value of the contingent consideration. 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 cost of debt financing for market participants.

The total allocable purchase price consists of the following:

Cash	$	8,928
Contingent consideration*		7,217
Total allocable purchase price	$	16,145

* Included cash earn-out of $6.7 million and 250,000 shares of equity contingent consideration at $1.91 per share, the closing stock price of the Company on February 10, 2011.

The following table summarizes the preliminary allocation of the aggregate purchase price to the fair value of the assets acquired and liabilities assumed as of the STA Acquisition Date:

Allocation of Purchase Price:		
Accounts receivable	$	2,093
Other assets		57
Goodwill(1)		4,347
Intangible assets		11,210
Accounts payable		(1,067)
Accrued expenses and other		(495)
Net assets acquired	$	16,145

(1) Goodwill of $4.3 million acquired in the acquisition is deductible for tax purposes.

The acquisition of STA is being treated as a business combination for accounting purposes while it is legally an asset purchase. Based on the valuation and other factors as described above, the purchase price assigned to intangible assets and the amortization period were as follows:

		Purchase Price Allocation	Asset Life
Amortizable intangible assets:			
Customer relationships	$	8,490	10 years
Backlog		1,880	2 years
Covenants not-to-compete		150	5 years
Non-amortizable intangible assets:			
Trademark and trade name		690	Indefinite
Total intangible assets	$	11,210	

We have not finalized our assessment of the fair values as of the issuance of this Form 10-Q since we have not completed our review of individual contracts, agreements, and accounting records of STA.

Compass results of operations have been included in the Company s financial statement for periods subsequent to the effective date of the acquisition. Compass contributed revenues of $22.1 million and net income of $0.1 million for the period from January 4, 2011 through June 30, 2011. STA s results of operations have been included in the Company s financial statement for periods subsequent to the effective date of the acquisition. STA contributed revenues of $5.7 million and net loss of $0.1 million for the period from February 10, 2011 through June 30, 2011.

The following unaudited pro forma financial information for the three and six months ended June 30, 2011 and 2010, assumes that the acquisitions of Compass and STA occurred at the beginning of the period presented. The unaudited proforma financial information is presented for information purposes only. Such information is based upon the stand alone historical results of each company and does not reflect the actual results that would have been reported had the acquisitions been completed when assumed, nor is it indicative of the future results of operations for the combined enterprise.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
Proforma	**2011**	**2010**	**2011**	**2010**
Revenues	$ 50,253	$ 47,211	$ 92,433	$ 95,214
Direct costs and expenses for advisors	27,718	26,769	53,381	54,160
Selling, general and administrative	17,163	16,380	36,112	33,248
Depreciation and amortization	2,859	2,520	5,722	5,512
Operating income (loss)	2,513	1,542	(2,782)	2,294
Other expense, net	(625)	(1,015)	(1,439)	(2,574)
Net income (loss) before taxes	1,888	527	(4,221)	(280)
Income tax (provision) benefit	(1,201)	(221)	2,827	87
Net income (loss)	$ 687	$ 306	$ (1,394)	$ (193)
Basic income (loss) per share	$ 0.02	$ 0.01	$ (0.04)	$ (0.01)
Diluted income (loss) per share	$ 0.02	$ 0.01	$ (0.04)	$ (0.01)

NOTE 5 INCOME TAXES

The Company s effective tax rate for the three and six months ended June 30, 2011 was 63.6% and 67.0% based on pretax income of $1.9 million and pretax loss of $4.1 million, respectively. This compared to 41.4% and 42.3% for the three and six months ended June 30, 2010, respectively.

As of June 30, 2011, the Company had total unrecognized tax benefits of approximately $2.3 million of which approximately $0.5 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 June 30, 2011, the Company s accrual of interest and penalties were $0.2 million.

NOTE 6 COMMITMENTS AND CONTINGENCIES

We are not involved in any material litigation nor, to our knowledge, is any material litigation pending or threatened against us. We are subject to contingencies that arise in the normal course of business. The potential liability, if any, in excess of amounts already accrued from all proceedings, claims and litigation will not have a material effect on our financial position or results of operations when resolved in a future period. All liabilities of which management is aware are properly reflected in the condensed consolidated financial statements at June 30, 2011 and December 31, 2010.

NOTE 7 GOODWILL

The changes in the carrying amount of goodwill for the six months ended June 30, 2011 is as follows:

Balance as of December 31, 2010		
Goodwill	$	144,428
Accumulated impairment losses		(95,954)
		48,474
Increase in goodwill related to acquisitions		20,913
Effect of foreign exchange rate changes		608
Balance as June 30, 2011		
Goodwill		165,949
Accumulated impairment losses		(95,954)
	$	69,995

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 8 COMPREHENSIVE (LOSS) INCOME

The following table presents the components of comprehensive (loss) income for the periods presented.

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income (loss)	$ 687	$ 186	$ (1,358)	$ 646
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax of $133, $(438), $751 and $(702), respectively	217	(712)	1,226	(1,145)
Comprehensive income (loss)	$ 904	$ (526)	$ (132)	$ (499)

NOTE 9 RESTRUCTURING ACCRUAL

Concurrent with the closing of the Compass acquisition, the Company initiated a program focused on implementing selected cost reductions and productivity improvements. The program is focused on integration-related cost synergies including selling, general and administrative support, elimination of unnecessary sales and advisory positions and real estate consolidations.

A summary of the activity affecting the Company s accrued contractual termination benefit liability for the six months ended June 30, 2011 is as follows:

	Workforce Reductions
Balance at December 31, 2010	$
Amounts accrued	1,668
Amounts paid/incurred	(1,189)
Adjustments	(179)
Balance at June 30, 2011	$ 300

The $1.5 million of contractual termination benefits, net of adjustments, was recorded in selling, general and administrative expenses. We expect that the remaining actions in our program will be completed over the next 3 to 6 months.

NOTE 10 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 June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Revenues				
Americas	$ 22,289	$ 19,981	$ 42,000	$ 41,138
Europe	21,999	9,433	37,957	19,688
Asia Pacific	5,965	3,958	10,954	7,390
	$ 50,253	$ 33,372	$ 90,911	$ 68,216

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 11 FINANCING ARRANGEMENTS AND LONG-TERM DEBT

On November 16, 2007, in connection with the Acquisition of TPI, International Consulting Acquisition Corp., a wholly-owned indirect subsidiary of ISG (the Borrower), entered into a senior secured credit facility comprised of a $95.0 million term loan facility and a $10.0 million revolving credit facility (collectively referred to as the 2007 Credit Agreement). On November 16, 2007, the Borrower borrowed $95.0 million under the term loan facility to finance the purchase of TPI.

On March 16, 2011, our lenders agreed to amend the total leverage ratio (as defined in the 2007 Credit Agreement) for the remaining life of the 2007 Credit Agreement to provide the Company with greater financing flexibility in return for additional quarterly term loan principal repayments. In accordance with the terms of the amended 2007 Credit Agreement, the Company made mandatory principal repayments of $3.0 million on March 31, 2011 and $1.0 million on June 30, 2011 and will make additional payments of $1.0 million on September 30, 2011 and December 31, 2011, respectively, to reduce the outstanding term loan balance to $63.8 million. The principal repayments will be made from cash generated through the Company s normal business operations.

Additional mandatory principal repayments totaling $7.0 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.

There were no borrowings under the revolving credit facility during 2011. The carrying amount of long-term debt owed to banks approximates fair value based on interest rates that are currently available to the Company for issuance of debt with similar terms and maturities.

On January 4, 2011, as part of the consideration for the Share Purchase, the Company issued an aggregate of $6.3 million in convertible notes to Compass. 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 the Company s 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 the Company s common stock at the rate of 1 share for every $4 in principal amount outstanding. After the Trigger Event, the Company may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

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, anticipa intend, plan, believe, estimate, forecast and similar expressions (or the negative of such expressions.) Forward-looking statements include statements concerning 2011 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 2010 Form 10-K titled Risk Factors.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2011 AND JUNE 30, 2010

On January 4, 2011, ISG completed the acquisition of Compass. Compass is a premier independent global provider of business and information technology benchmarking, performance improvement, data and analytics services. The company pioneered the aggregation and application of sophisticated metrics to understand root causes of organizational performance issues. In addition, their Fact-Based Consulting unit generates tangible improvements in client businesses through sourcing advisory programs, recommendations in operational excellence and support in implementing transformational change in business operations. 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, a premier 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 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.

The Company operates in one segment, fact-based sourcing advisory services. The Company operates principally in the Americas, Europe, and Asia Pacific. The Company s 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 June 30, (in thousands) 2011	2010	Change	Percent Change
Americas	$ 22,289	$ 19,981	$ 2,308	12%
Europe	21,999	9,433	12,566	133%
Asia Pacific	5,965	3,958	2,007	51%
Total revenues	$ 50,253	$ 33,372	$ 16,881	51%

The net increase in revenues of $16.9 million or 51% in 2011 was attributable principally to a 133% increase in Europe revenues to $22.0 million, a 12% increase in Americas to $22.3 million and a 51% increase in Asia Pacific revenues to $6.0 million. The increase in revenues is primarily due to the acquisitions of Compass and STA Consulting and higher levels of sourcing activity in Asia Pacific region, attributable to increases in post contract governance services. The translation of foreign currency into US dollars also favorably impacted performance compared to the prior year.

Operating Expenses

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

	Three Months Ended June 30, (in thousands)			
Operating Expenses	**2011**	**2010**	**Change**	**Percent Change**
Direct costs and expenses for advisors	$ 27,718	$ 17,779	$ 9,939	56%
Selling, general and administrative	17,163	12,224	4,939	40%
Depreciation and amortization	2,859	2,342	517	22%
Total operating expenses	$ 47,740	$ 32,345	$ 15,395	48%

Total operating expenses increased $15.4 million or 48% for the quarter with increases in direct expenses (56%) and selling, general and administrative (SG&A) expenses (40%) due primarily to the acquisitions of Compass and STA Consulting, higher compensation, contract labor, travel and bad debt expenses. These cost increases were only partially offset by lower professional fees and marketing expenses. The impact of foreign currency translation into US dollars drove costs higher compared to the same prior 2010 period.

In the second quarter of fiscal 2011, the Company recorded restructuring costs of $0.4 million associated with a program focused on implementing selected cost reductions and productivity improvements. The program is focused on integration-related cost synergies including selling, general and administrative support, elimination of unnecessary sales and advisory positions and real estate consolidations. Restructuring costs related to employee severance and benefit costs. The $0.4 million of restructuring costs was recorded in selling, general and administrative expenses. We expect that the remaining restructuring actions in our program will be completed over the next 3 to 6 months.

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.

The Company maintains 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 second quarter of 2011 and 2010 was $2.9 and $2.3 million, respectively. The increase was primarily due to the acquisitions of Compass and STA. The Company s 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. The Company also capitalizes 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.

The Company amortizes its intangible assets (e.g. client relationships and databases) over their estimated useful lives. Goodwill, trademark and trade names related to acquisitions are not amortized but are subject to annual impairment testing.

Other (Expense), Net

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

	Three Months Ended June 30, (in thousands)			
	2011	2010	Change	Percent Change
Interest income	$ 5	$ 51	$ (46)	(90)%
Interest expense	(793)	(794)	1	%
Foreign currency gain (loss)	163	33	130	394%
Total other expense, net	$ (625)	$ (710)	$ 85	12%

The decrease was primarily the result of foreign currency related gain offset by lower interest income.

Income Tax Expense

The Company s 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. The Company s effective tax rate for the three months ended June 30, 2011 was 63.6% compared to 41.4% for the three months ended June 30, 2010 primarily due to projected increased impact of state provisions based on revenue. The Company s operations resulted in a pre-tax income of $1.9 million and a tax provision of $1.2 million at the 63.6% effective tax rate for the three months ended June 30, 2011.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND JUNE 30, 2010

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

Revenues

Geographical revenue information for the segment is as follows:

	Six Months Ended June 30, (in thousands)			
Geographic Area	2011	2010	Change	Percent Change

Americas	$	42,000	$	41,138	$	862	2%
Europe		37,957		19,688		18,269	93%
Asia Pacific		10,954		7,390		3,564	48%
Total revenues	$	90,911	$	68,216	$	22,695	33%

The net increase in revenues of $22.7 million or 33% in 2011 was attributable principally to a 93% increase in Europe revenues to $37.9 million and a 48% increase in Asia Pacific revenues to $10.9 million. The increase in revenues is primarily due to the acquisitions of Compass and STA Consulting and higher levels of sourcing activity in Asia Pacific region, attributable to increases in post contract governance services. The translation of foreign currency into US dollars also favorably impacted performance compared to prior year.

Operating Expenses

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

	Six Months Ended June 30, (in thousands)			
Operating Expenses	**2011**	**2010**	**Change**	**Percent Change**
Direct costs and expenses for advisors	$ 51,948	$ 36,260	$ 15,688	43%
Selling, general and administrative	36,067	24,562	11,505	47%
Depreciation and amortization	5,570	4,701	869	18%
Total operating expenses	$ 93,585	$ 65,523	$ 28,062	43%

Total operating expenses increased $28.1 million or 43% for the first six months of 2011 with increases in direct expenses (43%) and selling, general and administrative (SG&A) expenses (47%) due primarily to the acquisitions of Compass and STA Consulting, one-time, deal-related costs, higher compensation, contract labor, conferences and travel expenses. These cost increases were only partially offset by lower professional fees and computer expenses. The impact of foreign currency translation into US dollars drove costs higher compared to the same prior 2010 period.

In the first six months of 2011, the Company recorded restructuring costs of $1.5 million associated with a program focused on implementing selected cost reductions and productivity improvements. The program is focused on integration-related cost synergies including selling, general and administrative support, elimination of unnecessary sales and advisory positions and real estate consolidations. Restructuring costs related to employee severance and benefit costs. The $1.5 million of restructuring costs was recorded in selling, general and administrative expenses. We expect that the remaining restructuring actions in our program will be completed over the next 3 to 6 months.

Depreciation and amortization expense in the first six months of 2011 and 2010 was $5.6 and $4.7 million, respectively. The increase was primarily due to the acquisitions of Compass and STA.

Other (Expense), Net

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

	Six Months Ended June 30, (in thousands)			
	2011	**2010**	**Change**	**Percent Change**
Interest income	$ 35	$ 86	$ (51)	(59)%
Interest expense	(1,675)	(1,588)	(87)	(5)%
Foreign currency gain (loss)	200	(72)	272	378%
Total other expense, net	$ (1,440)	$ (1,574)	$ 134	9%

The decrease was primarily the result of foreign currency related gain offset by higher interest expense as a result of the convertiblZE: 10pt; FONT-FAMILY: Times New Roman">**Other**

Totals

Net Interest Income	$ 10,007	$ 27	$ 26	$ (329)	$ 9,731
Net Gains on Sales of Loans and Related Assets	212	—	—	—	212
Net Gain on Securities	—	—	—	—	—
Trust and Investment Product Fees					

1

677

—

(25
)

653

Insurance Revenues

8

3

1,348

(10
)

1,349

Noncash Item:

Provision for Loan Losses

941

—

—

—

941

Depreciation and Amortization

537

6

210

—

753

Income Tax Expense

1,361

74

38

(307
)

1,166

Segment Profit / (Loss)

2,641

113

55

(301
)

2,508

Segment Assets

1,123,650

2,290

9,700

(48
)

1,135,592

Nine Months Ended September 30, 2008

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Net Interest Income	$ 31,203	$ 59	$ 55	$ (687)	$ 30,630
Net Gains on Sales of Loans and Related Assets	1,058	—	—	—	1,058
Net Gain on Securities	529	—	—	(350)	179

Trust and Investment Product Fees	4	1,864	—	(27)	1,841
Insurance Revenues	48	42	4,570	(48)	4,612
Noncash Item:					
Provision for Loan Losses	3,116	—	—	—	3,116
Depreciation and Amortization	1,893	21	612	—	2,526
Income Tax Expense	4,746	209	340	(874)	4,421
Segment Profit / (Loss)	9,453	308	548	(859)	9,450
Segment Assets	1,169,559	2,198	9,817	(2,973)	1,178,601

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited, dollars in thousands except per share data)

Note 6 – Segment Information (continued)

Nine Months Ended
September 30, 2007

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Net Interest Income	$ 29,358	$ 69	$ 84	$ (911)	$ 28,600
Net Gains on Sales of Loans and Related Assets	545	—	—	—	545
Net Gain on Securities	—	—	—	—	—
Trust and Investment Product Fees	3	2,069	—	(78)	1,994
Insurance Revenues	70	23	4,350	(49)	4,394
Noncash Item:					
Provision for Loan Losses	3,244	—	—	—	3,244
Depreciation and Amortization	1,762	16	601	—	2,379
Income Tax Expense	3,236	240	230	(863)	2,843
Segment Profit / (Loss)	6,923	366	340	(999)	6,630
Segment Assets	1,123,650	2,290	9,700	(48)	1,135,592

Note 7 – Stock Repurchase Plan

On April 26, 2001 the Company announced that its Board of Directors approved a stock repurchase program for up to 607,754 (as adjusted for subsequent stock dividends) of the outstanding Common Shares of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified by the program are purchased. As of September 30, 2008, the Company had purchased 334,965 (as adjusted for subsequent stock dividends) shares under the program. No shares were purchased under the plan during the nine months ended September 30, 2008.

Note 8 – Equity Plans and Equity Based Compensation

The Company maintains two equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At September 30, 2008, the Company has reserved 620,144 shares of Common Stock (as adjusted for subsequent stock dividends and subject to further customary anti-dilution adjustments) for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

For the nine months ended September 30, 2008 and 2007 there were no stock options granted. There was no option expense during the three or nine month periods ended September 30, 2008 and 2007. In addition, there was no unrecognized option expense as all outstanding options were fully vested prior to September 30, 2008 and 2007.

During the quarter and nine months ended September 30, 2008, the Company granted awards of 385 shares and 804 shares of restricted stock. During the quarter and nine months ended September 30, 2007, the Company granted awards of 397 shares and 21,797 shares of restricted stock. The expense recorded for the restricted stock grants totaled \$4, net of an income tax benefit of \$3, and \$6, net on an income tax benefit of \$4, during the three and nine months ended September 30, 2008, respectively. The expense recorded for the restricted stock grants totaled \$53, net of an income tax benefit of \$34, and \$136, net of an income tax benefit of \$89, during the three and nine months ended September 30, 2007, respectively. Unrecognized expense associated with the restricted stock grants totaled \$4 and \$58 as of September 30, 2008 and 2007, respectively.

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company’s common stock at a discount. The plan year for the Employee Stock Purchase Plan runs from August 17 through August 16 of the subsequent year. For years prior to the plan year beginning August 17, 2007, the purchase price of the shares were determined annually and in the range from 85% to 100% of the fair market value of such stock at either the beginning or end of the plan year. For the plan year beginning August 17, 2007 and the plan year beginning August 17, 2008, the purchase price of the shares under this Plan is 95% of the fair market value of the Company’s common stock as of the last day of the plan year. The plan provides for the purchase of up to 542,420 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. Funding for the purchase of common stock is from employee and Company contributions.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited, dollars in thousands except per share data)

Note 8 – Equity Plans and Equity Based Compensation (continued)

Based on the above referenced setting of the purchase price at 95% of the fair market value of the Company's common stock and elimination of the look-back feature for the 2007/2008 and the 2008/2009 plan years, the Employee Stock Purchase Plan was not and will not be considered compensatory and no expense was or will be recorded during the 2007/2008 and 2008/2009 plan years. The expense recorded for the Employee Stock Purchase Plan totaled $7 net of an income tax benefit of $5, and $29, net of an income tax benefit of $19, during the three and nine months ended September 30, 2007, respectively. There was no unrecognized compensation expense for the Employee Stock Purchase Plan as of September 30, 2008 and 2007.

Note 9 – Employee Benefit Plans

The Company acquired through previous bank mergers a noncontributory defined benefit pension plan with benefits based on years of service and compensation prior to retirement. The benefits under the plan were suspended in 1998. The following tables represent the components of net periodic benefit cost for the periods presented:

	Three Months Ended September 30,	
	2008	**2007**
Service Cost	$ —	$ —
Interest Cost	9	9
Expected Return on Assets	(3)	(3)
Amortization of Transition Amount	(1)	—
Amortization of Prior Service Cost	—	(1)
Recognition of Net (Gain)/Loss	5	7
Net Periodic Benefit Cost	$ 10	$ 12
Loss on Settlements and Curtailments	None	None

	Nine Months Ended September 30,	
	2008	**2007**
Service Cost	$ —	$ —
Interest Cost	28	28
Expected Return on Assets	(9)	(9)
Amortization of Transition Amount	(1)	(1)
Amortization of Prior Service Cost	(2)	(3)
Recognition of Net (Gain)/Loss	15	21
Net Periodic Benefit Cost	$ 31	$ 36
Loss on Settlements and Curtailments	None	45

The Company previously disclosed in its financial statements for the year ended December 31, 2007, that it expected to contribute $97 to the pension plan during the fiscal year ending December 31, 2008. As of September 30, 2008, the Company had contributed $81 to the pension plan.

Note 10 – New Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. The standard is effective for fiscal years beginning after November 15, 2007. Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited, dollars in thousands except per share data)

Note 10 – New Accounting Pronouncements (continued)

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at September 30, 2008 Using		
	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for Sale Securities	$ 147,947	$ 2,272	$ 143,933	$ 1,742

Equity securities that do not have readily determinable fair values are carried at cost and are evaluated for impairment on a periodic basis. Equity securities carried at cost and included in the table above totaled $2,092 at January 1, 2008 and $1,742 at September 30, 2008. The change in carrying value of these securities was attributable to an other-than-temporary impairment charge of $350 that was recognized on these securities during the quarter ended September 30, 2008.

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements at September 30, 2008 Using		
	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				

Impaired Loans	$	1,783	$	—	$	—	$	1,783

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $2,896, with a valuation allowance of $1,113, resulting in an additional provision for loan losses of $346 and $659 for the three and nine months ended September 30, 2008, respectively. Values for collateral dependent loans are generally based on appraisals obtained from licensed real estate appraisals and in certain circumstances consideration of offers obtained to purchase properties prior to foreclosure or other factors management deems relevant to arrive at a representative fair value. Appraisals for commercial real estate generally use three methods to derive value: cost, sales or market comparison and income approach. The cost method bases value in the cost to replace the current property. Values of market comparison approach evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and an investor's required return. The final fair value is based on the reconciliation of these three approaches.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited, dollars in thousands except per share data)

Note 10 – New Accounting Pronouncements (continued)

In February 2007, the FASB issued Statement No. 159 - *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or liabilities as of January 1, 2008 or subsequently.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue became effective for the Company on January 1, 2008. The impact of adoption of this issue was an adjustment to lower retained earnings of the Company by $288 effective January 1, 2008.

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings* ("SAB 109"). Previously, SAB 105, Application of Accounting Principles to Loan Commitments, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of adoption of this standard was not material to the Company's financial statements.

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

GERMAN AMERICAN BANCORP, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

German American Bancorp, Inc. is a financial services holding company based in Jasper, Indiana. The Company's Common Stock is traded on NASDAQ's Global Select Market, under the symbol GABC. The principal subsidiary of German American Bancorp, Inc. is its banking subsidiary, German American Bancorp, which operates through 28 retail banking offices in the ten contiguous Southern Indiana counties of Daviess, Dubois, Gibson, Knox, Lawrence, Martin, Monroe, Perry, Pike, and Spencer. German American Bancorp owns a trust, brokerage, and financial planning subsidiary, which operates from its banking offices, and a full line property and casualty insurance agency with seven insurance agency offices throughout its market area.

Throughout this Management's Discussion and Analysis, as elsewhere in this report, when we use the term "Company", we will usually be referring to the business and affairs (financial and otherwise) of the Company and its subsidiaries and affiliates as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc.

This section presents an analysis of the consolidated financial condition of the Company as of September 30, 2008 and December 31, 2007 and the consolidated results of operations for the three and nine months ended September 30, 2008 and 2007. This discussion should be read in conjunction with the consolidated financial statements and other financial data presented elsewhere herein and with the financial statements and other financial data, as well as the Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's December 31, 2007 Annual Report on Form 10-K.

MANAGEMENT OVERVIEW

This updated discussion should be read in conjunction with the Management Overview that was included in our Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's December 31, 2007 Annual Report on Form 10-K.

During the third quarter of 2008, the Company generated earnings of $3,319,000 or $0.30 per share, a 32% increase from the $2,508,000 or $0.23 per share in the third quarter of 2007. This level of quarterly earnings represents the fourth successive quarter that the Company has reported the highest level of quarterly earnings in its history. In comparison with prior year results, the Company's performance was enhanced during the third quarter of 2008 in each major category within the income statement reflecting increased revenue from both net interest income and total non-interest income coupled with flat non-interest expense. In addition, the Company's provision for loan loss declined modestly during the third quarter of 2008 compared with 2007. Each of these areas will be discussed in more detail below.

RECENT U.S. TREASURY DEPARTMENT AND FDIC DEVELOPMENTS

In October 2008, in response to a perceived economic emergency affecting the banking and financial markets, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA"). Pursuant to the EESA, the U. S. Department of the Treasury ("the Treasury") has authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U. S. financial markets.

As part of the EESA, the Treasury announced a program to purchase equity stakes in U. S. financial institutions. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program"), the Treasury will make $250 billion of capital available to U. S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the total amount of the preferred investment. The amount of capital available to each participating financial institution will be not less than one percent, or more than three percent, of that institution's risk weighted assets. Participating financial institutions will be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program and be restricted from increasing dividends to common shareholders or repurchasing common stock for three years without the consent of the Treasury.

Further, after receiving a recommendation from the boards of the Federal Deposit Insurance Corporation ("the FDIC") and the Federal Reserve System (the "Federal Reserve"), the Treasury in late October 2008 invoked the systemic risk exception to the Federal Deposit Insurance Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts, under a Temporary Liquidity Guarantee Program. Coverage under the Temporary Liquidity Guarantee Program is available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits.

The Company has not yet made a decision to participate in the Temporary Liquidity Guarantee Program or in the TARP Capital Purchase Program, or as to the amount of any capital that the Company may seek under the TARP Capital Purchase Program. The Company must make application by November 14, 2008, to seek to participate in the TARP Capital Purchase Program. Any election by the Company would be subject to approval by the Treasury and appropriate federal bank regulatory agencies. The Company must elect by December 5, 2008 if it intends to opt-out of the Temporary Liquidity Guarantee Program. It is not clear at this time what impact the EESA, the TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, other liquidity and funding initiatives of the Federal Reserve and other agencies that have been previously announced, and any additional programs that may be initiated in the future will have on the Company and the U. S. and global financial markets.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for German American Bancorp, Inc. presented in the Consolidated Financial Statements, accompanying Notes to the Consolidated Financial Statements, and selected financial data appearing elsewhere within this report, are, to a large degree, dependent upon the Company's accounting policies. The selection of and application of these policies involve estimates, judgments and uncertainties that are subject to change. The critical accounting policies and estimates that the Company has determined to be the most susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of securities available for sale, and income tax expense.

Allowance for Loan Losses

The Company maintains an allowance for loan losses to cover probable incurred credit losses at the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. A provision for loan losses is charged to operations based on management's periodic evaluation of the necessary allowance balance. Evaluations are conducted at least quarterly and more often if deemed necessary. The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control.

The Company has an established process to determine the adequacy of the allowance for loan losses. The determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on other classified loans and pools of homogeneous loans, and consideration of past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors, all of which may be susceptible to significant change. The allowance consists of two components of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover losses inherent in the loan portfolio.

Commercial and agricultural loans are subject to a standardized grading process administered by an internal loan review function. The need for specific reserves is considered for credits when graded substandard or special mention, or when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or, (d) other reasons where the ultimate collectibility of the loan is in question, or the loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired. Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including those graded substandard or special mention and non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

General allocations are made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a five-year historical average for loan losses for these portfolios, judgmentally adjusted for economic factors and portfolio trends.

Due to the imprecise nature of estimating the allowance for loan losses, the Company's allowance for loan losses may include a minor unallocated component. The unallocated component of the allowance for loan losses incorporates the Company's judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as economic uncertainties, lending staff quality, industry trends impacting specific portfolio segments, and broad portfolio quality trends. Therefore, the ratio of allocated to unallocated components within the total allowance may fluctuate from period to period.

Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, all securities are required to be written down to fair value when a decline in fair value is other than temporary; therefore, future changes in the fair value of securities could have a significant impact on the Company's operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline and the duration of the decline. As of September 30, 2008, gross unrealized losses on the securities available-for-sale portfolio totaled approximately $524,000.

Income Tax Expense

Income tax expense involves estimates related to the valuation allowance on deferred tax assets and loss contingencies related to exposure from tax examinations.

A valuation allowance reduces deferred tax assets to the amount management believes is more likely than not to be realized. In evaluating the realization of deferred tax assets, management considers the likelihood that sufficient taxable income of appropriate character will be generated within carryback and carryforward periods, including consideration of available tax planning strategies. As of December 31, 2007, the Company had a deferred tax asset of $649,000 which includes tax credit carryforwards of $403,000. Based on the long carryforward periods available, management has assessed it more likely than not that these credits will be realized and no valuation allowance has been established on this asset.

Tax-related loss contingencies, including assessments arising from tax examinations and tax strategies, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In considering the likelihood of loss, management considers the nature of the contingency, the progress of any examination or related protest or appeal, the views of legal counsel and other advisors, experience of the Company or other enterprises in similar matters, if any, and management's intended response to any assessment.

RESULTS OF OPERATIONS

Net Income:

Net income increased $811,000 or 32% to $3,319,000 or $0.30 per share for the quarter ended September 30, 2008, compared to $2,508,000 or $0.23 per share for the third quarter of 2007. The increase in net income during the third quarter 2008 compared with same quarter of 2007 was due to improvement across the major categories of the income statement including net interest income, non-interest income, lower provision for loan losses combined with relatively stable non-interest expense.

Net income for the first nine months of 2008 totaled 9,450,000 or $0.85 per share representing an increase of $2,820,000 or 43% over the $6,630,000 or $0.60 per share recorded in the nine months ended September 30, 2007. The increase in net income during the nine months ended September 30, 2008 compared with the same period of 2007 was attributable to improvement in net interest income, non-interest income and expense, and a modestly lower provision for loan losses.

Net Interest Income:

Net interest income is the Company's single largest source of earnings, and represents the difference between interest and fees realized on earning assets, less interest paid on deposits and borrowed funds. The following table summarizes the Company's net interest income (on a tax-equivalent basis, at an effective tax rate of 34%) for each of the periods presented herein (dollars in thousands):

	Three Months Ended September 30,				Change from Prior Period		
	2008		2007		Amount		Percent
Interest Income (T/E)	$	16,879	$	18,770	$	(1,891)	(10.1)%
Interest Expense		6,283		8,907		(2,624)	(29.5)%
Net Interest Income (T/E)	$	10,596	$	9,863		733	7.4%

Net interest income increased $715,000 or 7% (an increase of $733,000 or 7% on a tax-equivalent basis) for the quarter ended September 30, 2008 compared with the same quarter of 2007. The net interest margin represents tax-equivalent net interest income expressed as a percentage of average earning assets. The tax equivalent net interest margin for the third quarter 2008 was 3.89% compared to 3.78% for the third quarter of 2007. The yield on earning assets totaled 6.19% during the quarter ended September 30, 2008 compared to 7.18% in the same period of 2007 while the cost of funds (expressed as a percentage of average earning assets) totaled 2.30% during 2008 compared to 3.40% in 2007.

Average earning assets totaled approximately $1.086 billion for the quarter ended September 30, 2008 compared with $1.038 billion for the quarter ended September 30, 2007. During the third quarter of 2008, average loans outstanding totaled $889.2 million, an increase of $25.8 million or 3%, compared to the $863.4 million in average loans outstanding during the third quarter of 2007. Average commercial and agricultural loans totaled $651.4 million, an increase of $42.6 million or 7% during the quarter ended September 30, 2008 compared with the same quarter of the prior year. Average residential mortgage loans and consumer loans totaled $237.8 million during the quarter ended September 30, 2008 representing a decline of $16.8 million or 7% over 2007.

	Nine Months Ended September 30,				Change from Prior Period		
	2008		2007		Amount		Percent
Interest Income (T/E)	$	51,741	$	54,386	$	(2,645)	(4.9)%
Interest Expense		20,702		25,325		(4,623)	(18.3)%
Net Interest Income (T/E)	$	31,039	$	29,061	$	1,978	6.8%

Net interest income increased $2,030,000 or 7% (an increase of $1,978,000 or 7% on a tax-equivalent basis) for the nine months ended September 30, 2008 compared with the nine months ended September 30, 2007. The tax equivalent net interest margin for the nine months ended September 30, 2008 was 3.84% compared to 3.81% for the same period of 2007. The yield on earning assets totaled 6.41% during the nine months ended September 30, 2008 compared to 7.13% in the same period of 2007 while the cost of funds (expressed as a percentage of average earning assets) totaled 2.57% during 2008 compared to 3.32% in 2007.

Average earning assets totaled approximately $1.077 billion for the nine months ended September 30, 2008 compared with $1.019 billion for the nine months ended September 30, 2007. During the first nine months of 2008, average loans outstanding totaled $876.7 million, an increase of $44.1 million or 5%, compared to the $832.6 million in average loans outstanding during the first nine months of 2007. Average commercial and agricultural loans totaled $633.1 million, an increase of $51.4 million or 9% during the nine months ended September 30, 2008 compared with the same period of the prior year. Average residential mortgage loans and consumer loans totaled $243.6 million during the nine months ended September 30, 2008 representing a decrease of $7.3 million or 3% over the same period of 2007.

Provision for Loan Losses:

The Company provides for loan losses through regular provisions to the allowance for loan losses. The provision is affected by net charge-offs on loans and changes in specific and general allocations of the allowance. The provision for loan loss totaled $838,000 during the quarter ended September 30, 2008, representing a decrease of $103,000 from the third quarter 2007 provision of $941,000. During the third quarter of 2008, the annualized provision for loan loss represented 0.38% of average loans outstanding compared with 0.44% on an annualized basis of average loans outstanding during the third quarter of 2007.

The provision for loan loss totaled $3,116,000 during the nine months ended September 30, 2008, representing a decline of $128,000 from the nine months ended September 30, 2007 provision of $3,244,000. During the nine months ended September 30, 2008, the annualized provision for loan loss represented 0.47% of average loans outstanding compared with 0.52% on an annualized basis of average loans outstanding during the nine months ended September 30, 2007.

Net charge-offs totaled $1,333,000 or 0.60% on an annualized basis of average loans outstanding during the three months ended September 30, 2008 compared with $662,000 or 0.31% on an annualized basis of average loans outstanding during the same period of 2007. During the third quarter of 2008, one single commercial credit charge-off totaled $1.2 million and represented 54 basis points of average loans for the quarter ended September 30, 2008. The charge-off amount for this credit was fully provided for in prior periods. In addition, this commercial credit was moved to other real estate owned during the third quarter 2008 and has subsequently been sold in the fourth quarter 2008 with no additional loss associated with the property.

Net charge-offs totaled $1,802,000 or 0.27% on an annualized basis of average loans outstanding during the nine months ended September 30, 2008 compared with $2,318,000 or 0.37% on an annualized basis of average loans outstanding during the same period of 2007. The higher level of net charge-offs during the nine months ended September 30, 2007, was primarily attributable to the charge-off related to a single large commercial credit facility that occurred during the first half of 2007.

The provisions for loan losses made during the quarter ended September 30, 2008 were made at a level deemed necessary by management to absorb estimated, probable incurred losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for loan losses is completed quarterly by management, the results of which are used to determine provisions for loan losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors.

Non-interest Income:

During the third quarter of 2008, non-interest income totaled $4,324,000 representing an increase of $316,000 or 8% over the third quarter of 2007. During the nine months ended September 30, 2008, non-interest income totaled $13,849,000 representing an increase of $1,664,000 or 14% over the same period of 2007.

Deposit service charges and fees totaled $1,293,000 during the quarter ended September 30, 2008 representing an increase of $171,000 or 15% over the same period of 2007. Deposit service charges and fees totaled $3,721,000 during the nine months ended September 30, 2008 representing an increase of $567,000 or 18% over the same period of 2007. The increase was attributable to a combination of increased gross fees and a reduced level of refunded and waived fees.

During the third quarter of 2008, insurance commission and fees totaled $1,402,000 which is an increase of $53,000 or 4% compared to the third quarter of 2007. During the nine month period ended September 30, 2008, insurance commission and fees totaled $4,612,000 which is an increase of $218,000 or 5% compared to 2007. The increase was attributable to an increase of $316,000 in contingency revenue during the first half of 2008 compared with the first half of 2007.

During the quarter ended September 30, 2008, the net gain on sale of residential loans totaled $330,000, an increase of $118,000 or 56% over the gain recognized in the quarter ended September 30, 2007. The increase was attributable to higher levels of residential loan sales which totaled $23.7 million in the third quarter of 2008, compared to $17.6 million in the same period of 2007 combined with a higher margin on the loans sold. During the nine months ended September 30, 2008, the net gain on sale of residential loans totaled $1,058,000, an increase of $513,000 or 94% over the gain of $545,000 recognized in the nine months ended September 30, 2007. The increase was attributable to higher levels of residential loan sales which totaled $84.4 million in the first nine months of 2008, compared to $45.2 million in the same period of 2007.

The Company recognized a net loss on securities of $106,000 in the third quarter of 2008. The Company sold approximately $18 million of agency mortgage related securities at a gain of $244,000 during the third quarter 2008. Also, during the quarter ended September 30, 2008, the Company recognized an other-than-temporary impairment expense of $350,000 on its portfolio of non-controlling investments in other banking organizations. The Company has no investments in agency preferred securities.

The Company recognized a net gain on securities of $179,000 in the nine months ended September 30, 2008. The Company sold approximately $34 million of agency mortgage related securities at a gain of $433,000 during the nine months ended 2008. In addition, the Company recognized a gain of $96,000 on the mandatory redemption on a portion of VISA stock acquired as part of the initial public offering of VISA, Inc. These gains were partially offset by the other-than-temporary impairment expense of $350,000 on its portfolio of non-controlling investments in other banking organizations recognized during the third quarter of 2008.

Non-interest Expense:

During the quarter ended September 30, 2008, non-interest expense totaled $9,159,000, an increase of $35,000 or less than 1% from the same period of 2007. During the nine months ended September 30, 2008, non-interest expense totaled $27,492,000, a decline of $576,000 or 2% from the same period of 2007.

Salaries and benefits totaled $5,225,000 in the quarter ended September 30, 2008 representing a decline of $170,000 or 3% from the same quarter of 2007. Salaries and benefits totaled $15,670,000 in the nine months ended September 30, 2008 representing a decline of $782,000 or 5% from the same period of 2007. The decline was largely attributable to a decrease of approximately 24 full time equivalent employees ("FTE"), or 6% of total FTEs, and 29 full-time equivalent employees, or 7% of total FTEs, during the three and nine months ended September 30, 2008 compared with the same periods of 2007. The decline in salaries and benefits was also achieved while the company recognized $196,000 and $662,000 for post-retirement benefits for employees that were accrued as part of the Company's formal review of effectiveness and efficiency during the three and nine months ended September 30, 2008.

In the quarter ended September 30, 2008, occupancy and furniture and equipment expense totaled $1,408,000, an increase of $79,000 or 6% compared to the quarter ended September 30, 2007. During the nine months ended September 30, 2008, occupancy and furniture and equipment expense totaled $4,278,000, an increase of $251,000 or 6% compared to the nine months ended September 30, 2007. The increases were largely attributable to higher levels of furniture, fixtures and equipment depreciation.

Professional fees increased $108,000 or 42% during the third quarter of 2008 and $372,000 or 37% during the nine months ended September 30, 2008, compared with the same periods of 2007. The increases were due primarily to professional fees associated with the Company's formal review of effectiveness and efficiency.

Other operating expenses increased $18,000 or 1% during the third quarter of 2008 and declined $637,000 or 14% during the nine months ended September 30, 2008, compared with the same periods of 2007. During the nine months ended September 30, 2008, collection costs declined by $225,000, respectively, as compared with the same periods of 2007. The decline was largely due to an elevated level in 2007 related to the resolution of a single large non-performing commercial credit facility during the first half of 2007. During the nine months ended September 30, 2008, losses related to fraudulent ATM/debit card transactions decreased by $90,000 compared with the same period of 2007; however, during the third quarter of 2008 these types of losses increased by $79,000 over the same period of 2007.

Income Taxes:

The Company's effective income tax rate approximated 30.5% during the three months ended September 30, 2008 compared with 31.7% during the same period of 2007. The Company's effective income tax rate approximated 31.9% during the nine months ended September 30, 2008 compared with 30.0% during the same period of 2007. The effective tax rate in both 2008 and 2007 was lower than the blended statutory rate of 39.6% resulting primarily from the Company's tax-exempt investment income on securities and loans, income tax credits generated from investments in affordable housing projects, and income generated by subsidiaries domiciled in a state with no state or local income tax.

FINANCIAL CONDITION

Total assets at September 30, 2008 increased $46.9 million to $1.179 billion compared with $1.132 billion in total assets at December 31, 2007. Cash and cash equivalents increased $10.9 million to $38.8 million at September 30, 2008 compared with $27.9 million at year-end 2007. This increase was largely attributable to an increase in deposits during 2008. Securities available-for-sale and held-to-maturity remained relatively stable declining $1.4 million to $151.4 million at September 30, 2008 compared with $152.8 million at year-end 2007. Accrued interest receivable and other assets increased $18.1 million to $32.6 million at September 30, 2008 compared with $14.5 million at year-end 2007. This increase, along with the stable comparison of securities, was attributable to the sale of and subsequent reclassification to accounts receivable from securities available-for-sale of approximately $18 million of agency mortgage related securities that settled early in the fourth quarter of 2008. The proceeds from the sale settlement have been subsequently reinvested back into the securities available-for-sale portfolio during the fourth quarter of 2008.

Loans, net of unearned income, increased $19.1 million to $886.8 million at September 30, 2008 compared to $867.7 million at December 31, 2007. Commercial and industrial loans increased $42.4 million or 9%, agricultural based loans decreased $8.5 million or 5%, consumer loans decreased $3.0 million or 2% and residential mortgage loans declined $12.5 million or 11% during the nine months ended September 30, 2008.

Total Deposits at September 30, 2008, increased $29.0 million to $906.4 million compared with $877.4 million in total deposits at December 31, 2007. Demand, savings, and money market accounts increased $78.2 million while time deposits decreased $49.2 million. FHLB Advances and other borrowings increased $13.7 million to $157.9 million at September 30, 2008 compared to $144.2 million at year-end 2007.

Non-performing Assets:

The following is an analysis of the Company’s non-performing assets at September 30, 2008 and December 31, 2007 (dollars in thousands):

	September 30, 2008	December 31, 2007
Non-accrual Loans	$ 7,385	$ 4,356
Past Due Loans (90 days or more)	34	8
Restructured Loans	—	—
Total Non-performing Loans	7,419	4,364
Other Real Estate	3,757	1,517
Total Non-performing Assets	$ 11,176	$ 5,881
Non-performing Loans to Total Loans	0.84%	.50%
Allowance for Loan Loss to Non-performing Loans	126.14%	184.33%

The Company’s level of overall non-performing assets increased by approximately $5.3 million and non-performing loans increased by approximately $3.1 million during the nine months ended September 30, 2008. Other real estate increased $2.2 million during the nine months ended September 30, 2008 with the majority of the increase in other real estate related to a single commercial real estate property which was originally a participation loan in which the Company was a 53% participant in a newly constructed apartment complex. This property was acquired through foreclosure in the third quarter of 2008. The Company’s balance at September 30, 2008 in other real estate related to this property was $1.7 million after a partial charge-off of $1.2 million. The property has been subsequently sold in fourth quarter of 2008 with no additional loss associated with the property.

The Company’s level of non-performing loans increased by approximately $3.1 million to $7.4 million during the nine months ended September 30, 2008. This level of non-performing loans represents 0.84% of total loans outstanding at September 30, 2008, an increase from 0.50% as of year-end 2007. The increase in non-performing loans was primarily related to commercial credits that each totaled less than $1.0 million.

Capital Resources:

Federal banking regulations provide guidelines for determining the capital adequacy of bank holding companies and banks. These guidelines provide for a more narrow definition of core capital and assign a measure of risk to the various categories of assets. The Company is required to maintain minimum levels of capital in proportion to total risk-weighted assets and off-balance sheet exposures such as loan commitments and standby letters of credit.

Tier 1, or core capital, consists of shareholders’ equity less goodwill, core deposit intangibles, other identifiable intangibles and certain deferred tax assets defined by bank regulations. Tier 2 capital currently consists of the amount of the allowance for loan losses which does not exceed a defined maximum allowance limit of 1.25 percent of gross risk adjusted assets and subordinated debenture obligations. Total capital is the sum of Tier 1 and Tier 2 capital.

The minimum requirements under these standards are generally at least a 4.0 percent leverage ratio, which is Tier 1 capital divided by defined “total assets”; 4.0 percent Tier 1 capital to risk-adjusted assets; and, an 8.0 percent total capital to risk-adjusted assets ratios. Under these guidelines, the Company, on a consolidated basis, and its subsidiary bank, have capital ratios that exceed the regulatory minimums.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires federal regulatory agencies to define capital tiers. These are: well-capitalized, adequately-capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized. Under these regulations, a “well-capitalized” entity must achieve a Tier 1 risk-based capital ratio of at least 6.0 percent; a total capital ratio of at least 10.0 percent; and, a leverage ratio of at least 5.0 percent, and not be under a capital directive. The Company’s subsidiary bank was categorized as well-capitalized as of September 30, 2008.

At September 30, 2008, management was not under such a capital directive, nor was it aware of any current recommendations by banking regulatory authorities which, if they were to be implemented, would have or are reasonably likely to have, a material effect on the Company's liquidity, capital resources or operations.

The table below presents the Company's consolidated capital ratios under regulatory guidelines:

	Minimum for Capital Adequacy Purposes	At September 30, 2008	At December 31, 2007
Leverage Ratio	4.00%	7.52%	7.41%
Tier 1 Capital to Risk-adjusted Assets	4.00%	9.10%	8.69%
Total Capital to Risk-adjusted Assets	8.00%	11.11%	10.63%

As of September 30, 2008, shareholders' equity increased by $3.9 million to $101.0 million compared with $97.1 million at year-end 2007. The increase in shareholders' equity was attributable to an increase of $4.5 million in retained earnings and a decline of $584,000 in accumulated other comprehensive income. Shareholders' equity represented 8.6% of total assets at September 30, 2008 and at December 31, 2007. Shareholders' equity included $13.0 million of goodwill and other intangible assets at September 30, 2008, compared to $13.7 million of goodwill and other intangible assets at December 31, 2007.

Liquidity:

The Consolidated Statement of Cash Flows details the elements of changes in the Company's consolidated cash and cash equivalents. Total cash and cash equivalents increased $10.8 million during the nine months ended September 30, 2008 ending at $38.8 million. During the nine months ended September 30, 2008, operating activities resulted in net cash outflows of $3.3 million. Investing activities resulted in net cash outflows of $23.9 million during the nine months ended September 30, 2008 due primarily to growth in the Company's loan portfolio. Financing activities resulted in net cash inflows for the period ended September 30, 2008 of $38.0 million due primarily to growth of deposits of $29.0 million and growth in borrowed funds of $13.7 million offset partially by a net cash outflow of $4.6 million in dividends paid to shareholders.

Parent Company Liquidity and Capital Resources:

The Company is a corporation separate and distinct from its bank and other subsidiaries. The Company uses funds at the parent company level to pay dividends to its shareholders, to acquire or make other investments in other businesses or their securities or assets, to repurchase its stock from time to time, and for other general corporate purposes. The parent company does not have access at the parent-company level to the deposits and certain other sources of funds that are available to its bank subsidiaries to support their operations. Instead, the parent company has historically derived most of its revenues from dividends paid to the parent company by its bank subsidiary. The bank subsidiary is subject to statutory restrictions on its ability to pay dividends to the parent company.

The parent company has in recent years supplemented the dividends received from its subsidiaries with borrowings under a credit facility established with JPMorgan Chase Bank, N.A. (the "Lender"). On September 30, 2008, the Company and Lender executed and delivered to each other an amendment to the Second Amended and Restated Loan and Subordinated Debenture Purchase Agreement dated December 29, 2006, as previously amended in September 2007 (as amended, the "Loan Agreement") between the Lender and the Company. Pursuant to this 2008 amendment, the Company's revolving line of credit established by the Loan Agreement (which was to have expired and become due September 30, 2008) was extended through September 30, 2009. The amount of the credit available to the

Company under the revolving line of credit is $10 million under the terms of the Loan Agreement. In addition, the interest rate payable by the Company to the Lender in respect of LIBOR-based advances under the Loan Agreement is LIBOR plus 165 basis points, and the Loan Agreement includes a provision for a non-refundable fee on the unused portion of the maximum amount available under the line of credit of 35 basis points per annum, due quarterly in arrears.

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

The Company from time to time in its oral and written communications makes statements relating to its expectations regarding the future. These types of statements are considered “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. The Company may include forward-looking statements in filings with the Securities and Exchange Commission (“SEC”), such as this Form 10-Q, in other written materials, and in oral statements made by senior management to analysts, investors, representatives of the media, and others. Such forward looking statements can include statements about the Company’s plans to participate, or to not participate, in the TARP Capital Purchase Plan or Temporary Liquidity Guarantee Program (or both), or the financial or other impacts of any such participation; plans to increase its operating effectiveness upon future non-interest income and non-interest expense: the Company’s net interest income or net interest margin; its adequacy of allowance for loan losses, levels of provisions for loan losses, and the quality of the Company’s loans and other assets; simulations of changes in interest rates; expected results from mergers with or acquisitions of other businesses; litigation results; tax estimates and recognition; dividend policy; parent company cash resources and cash requirements, and parent company capital resources; estimated cost savings, plans and objectives for future operations; and expectations about the Company’s financial and business performance and other business matters as well as economic and market conditions and trends. They often can be identified by the use of words like “expect,” “may,” “will,” “would,” “could,” “should,” “intend,” “project,” “believe” or “anticipate,” or similar expressions.

It is intended that these forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the forward-looking statement is made. Readers are cautioned that, by their nature, forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially from the expectations of the Company that are expressed or implied by any forward-looking statement.

Readers are cautioned that, by their nature, all forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially and adversely from the expectations of the Company that are expressed or implied by any forward-looking statement. The discussions in this Item 2 list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statements. Other risks, uncertainties, and factors that could cause the Company’s actual results to vary materially from those expressed or implied by any forward-looking statement include the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates; the effects of changes in competitive conditions; of the possibility that the Company may acquire other businesses or intangible customer relationships of other companies and the costs of integrations of such acquired businesses and intangible customer relationships; the introduction, withdrawal, success, and timing of business initiatives and strategies, including asset/liability management strategies; changes in customer borrowing, repayment, investment, and deposit practices; changes in fiscal, monetary, and tax policies; changes in financial and capital markets including those arising from the continuing uncertainties commonly associated with the mortgage-backed securities markets and the auction-rate securities markets, the financial stability of bond insurers, and the unknown impact upon the financial and credit markets of the exercise by the Treasury of its authority under the EESA; the possibility of a recession or other adverse change in general economic conditions, either nationally or regionally, resulting in, among other things, credit quality deterioration; the impact, extent and timing of technological changes; possible future capital management activities that the Company may utilize, including possible future sales or repurchases or redemptions by the Company of debt or equity securities issued by it or that it may issue, under the TARP Capital Purchase Program or the Temporary Liquidity Guarantee Program (or both) or otherwise; actions of the Federal Reserve Board; actions of the Treasury and the Federal Deposit Insurance Corporation under the EESA and the Federal Deposit Insurance Act, and other legislative and regulatory actions and reforms; changes in accounting principles and interpretations; the inherent uncertainties involved in litigation and regulatory proceedings which could result in the Company’s incurring loss or damage regardless of the merits of the Company’s claims or defenses; and the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

Investors should consider these risks, uncertainties, and other factors, in addition to those mentioned by the Company in its Annual Report on Form 10-K for its fiscal year ended December 31, 2007, and its Quarterly Report on Form 10-Q for its quarters ended March 31, 2008, and June 30, 2008, and other SEC filings from time to time, when considering any forward-looking statement.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee and Boards of Directors of the parent company and its subsidiary bank. Primary market risks which impact the Company's operations are liquidity risk and interest rate risk.

The liquidity of the parent company is dependent upon the receipt of dividends from its subsidiary bank, which is subject to certain regulatory limitations. The bank's source of funding is predominately core deposits, maturities of securities, repayments of loan principal and interest, federal funds purchased, securities sold under agreements to repurchase and borrowings from the Federal Home Loan Bank.

The Company monitors interest rate risk by the use of computer simulation modeling to estimate the potential impact on its net interest income under various interest rate scenarios, and by estimating its static interest rate sensitivity position. Another method by which the Company's interest rate risk position can be estimated is by computing estimated changes in its net portfolio value ("NPV"). This method estimates interest rate risk exposure from movements in interest rates by using interest rate sensitivity analysis to determine the change in the NPV of discounted cash flows from assets and liabilities.

NPV represents the market value of portfolio equity and is equal to the estimated market value of assets minus the estimated market value of liabilities. Computations are based on a number of assumptions, including the relative levels of market interest rates and prepayments in mortgage loans and certain types of investments. These computations do not contemplate any actions management may undertake in response to changes in interest rates, and should not be relied upon as indicative of actual results. In addition, certain shortcomings are inherent in the method of computing NPV. Should interest rates remain or decrease below current levels, the proportion of adjustable rate loans could decrease in future periods due to refinancing activity. In the event of an interest rate change, prepayment levels would likely be different from those assumed in the table. Lastly, the ability of many borrowers to repay their adjustable rate debt may decline during a rising interest rate environment.

The table below provides an assessment of the risk to NPV in the event of a sudden and sustained 2% increase and decrease in prevailing interest rates (dollars in thousands).

Interest Rate Sensitivity as of September 30, 2008

	Net Portfolio Value		Net Portfolio Value as a % of Present Value of Assets	
Changes in rates	**$ Amount**	**% Change**	**NPV Ratio**	**Change**
+2%	$ 138,141	-6.57%	12.02%	(48) b.p.
Base	147,853	—	12.50%	—
-2%	141,732	-4.14%	11.75%	(75) b.p.

This Item 3 includes forward-looking statements. See "Forward-looking Statements" included in Part I, Item 2 of this Report for a discussion of certain factors that could cause the Company's actual exposure to market risk to vary materially from that expressed or implied above. These factors include possible changes in economic conditions; interest rate fluctuations, competitive product and pricing pressures within the Company's markets; and equity and fixed income market fluctuations. Actual experience may also vary materially to the extent that the Company's assumptions described above prove to be inaccurate.

Item 4. Controls and Procedures

As of September 30, 2008, the Company carried out an evaluation, under the supervision and with the participation of its principal executive officer and principal financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were as of that date effective in timely alerting them to material information required to be included in the Company's periodic reports filed with the Securities and Exchange Commission. There are inherent limitations to the effectiveness of systems of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective systems of disclosure controls and procedures can provide only reasonable assurances of achieving their control objectives.

There was no change in the Company’s internal control over financial reporting that occurred during the Company’s third fiscal quarter of 2008 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

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

(e) The following table sets forth information regarding the Company's purchases of its common shares during each of the three months ended September 30, 2008.

Period	Total Number Of Shares (or Units) Purchased	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs [1]
7/1/08 – 7/31/08	—	—	—	272,789
8/1/08 – 8/31/08	—	—	—	272,789
9/1/08 – 9/30/08	—	—	—	272,789
	—	—	—	

[1] On April 26, 2001, the Company announced that its Board of Directors had approved a stock repurchase program for up to 607,754 of its outstanding common shares, of which the Company had purchased 334,965 common shares through September 30, 2008 (both such numbers adjusted for subsequent stock dividends). The Board of Directors established no expiration date for this program. The Company purchased no shares under this program during the nine months ended September 30, 2008.

Item 6. Exhibits

The exhibits described by the Exhibit Index immediately following the Signature Page of this Report are incorporated herein by reference.

SIGNATURES

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

	GERMAN AMERICAN BANCORP, INC.
Date: November 6, 2008	By/s/Mark A. Schroeder Mark A. Schroeder President and Chief Executive Officer
Date: November 6, 2008	By/s/Bradley M. Rust Bradley M. Rust Executive Vice President and Chief Financial Officer

INDEX OF EXHIBITS

Exhibit No.	Description
10.1	Second Amendment dated September 30, 2008, to Second Amended and Restated Loan and Subordinated Debenture Purchase Agreement dated as of December 29, 2006, by and between JPMorgan Chase Bank, N.A. and German American Bancorp, Inc.
31.1	Sarbanes-Oxley Act of 2002, Section 302 Certification for President and Chief Executive Officer.
31.2	Sarbanes-Oxley Act of 2002, Section 302 Certification for Senior Vice President and Chief Financial Officer.
32.1	Sarbanes-Oxley Act of 2002, Section 906 Certification for President and Chief Executive Officer.
32.2	Sarbanes-Oxley Act of 2002, Section 906 Certification for Senior Vice President and Chief Financial Officer.