

Information Services Group Inc.
Form 10-Q
November 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from to

Commission File Number 001-33287

INFORMATION SERVICES GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	20-5261587
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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2187 Atlantic Street
Stamford, CT 06902
(Address of principal executive offices and zip code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Class	Outstanding at October 26, 2018
Common Stock, \$0.001 par value	45,186,419 shares



CAUTIONARY NOTE REGARDING

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,” “continue,” or 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)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	\$ 13,510	\$ 28,420
Accounts receivable and contract assets, net of allowance of \$770 and \$503, respectively	76,403	70,824
Prepaid expenses and other current assets	4,277	4,467
Total current assets	94,190	103,711
Restricted cash	91	94
Furniture, fixtures and equipment, net	6,896	5,229
Goodwill	85,446	85,619
Intangible assets, net	21,868	25,684
Deferred tax assets	2,997	2,521
Other assets	1,069	1,902
Total assets	\$ 212,557	\$ 224,760
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 8,016	\$ 7,192
Current maturities of long-term debt	8,250	15,499
Contract liabilities	4,794	8,898
Accrued expenses	17,621	21,486
Total current liabilities	38,681	53,075
Long-term debt, net of current maturities	91,113	98,838
Deferred tax liabilities	1,891	1,569
Other liabilities	4,362	7,741
Total liabilities	136,047	161,223
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, \$0.001 par value; 10,000 shares authorized; none issued	—	—
Common stock, \$0.001 par value, 100,000 shares authorized; 45,193 shares issued and 45,138 outstanding at September 30, 2018 and 44,490 shares issued and 43,560 outstanding at December 31, 2017	45	44

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Additional paid-in capital	233,394	230,134
Treasury stock (55 and 930 common shares, respectively, at cost)	(228)	(3,161)
Accumulated other comprehensive loss	(7,456)	(5,666)
Accumulated deficit	(149,245)	(157,814)
Total stockholders' equity	76,510	63,537
Total liabilities and stockholders' equity	\$ 212,557	\$ 224,760

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

2

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues	\$ 67,965	\$ 68,349	\$ 207,868	\$ 202,942
Operating expenses				
Direct costs and expenses for advisors	38,624	38,214	121,761	119,153
Selling, general and administrative	23,990	23,710	70,898	68,815
Depreciation and amortization	1,977	2,951	5,872	9,773
Operating income	3,374	3,474	9,337	5,201
Interest income	3	15	113	94
Interest expense	(1,675)	(1,716)	(5,140)	(5,132)
Foreign currency transaction (loss) gain	(6)	(111)	19	(292)
Income (loss) before taxes	1,696	1,662	4,329	(129)
Income tax (benefit) provision	(2,307)	234	(2,200)	(681)
Net income	\$ 4,003	\$ 1,428	\$ 6,529	\$ 552
Net income attributable to non-controlling interest	—	—	—	32
Net income attributable to ISG	\$ 4,003	\$ 1,428	\$ 6,529	\$ 520
Weighted average shares outstanding:				
Basic	45,115	43,305	44,491	42,893
Diluted	47,100	44,658	46,349	43,344
Earnings per share attributable to ISG:				
Basic	\$ 0.09	\$ 0.03	\$ 0.15	\$ 0.01
Diluted	\$ 0.08	\$ 0.03	\$ 0.14	\$ 0.01
Comprehensive income:				
Net income	\$ 4,003	\$ 1,428	\$ 6,529	\$ 552
Foreign currency translation, net of tax benefit (expense) of \$110, \$(232), \$421 and \$(1,161), respectively.	(786)	601	(1,790)	1,950
Comprehensive income	\$ 3,217	\$ 2,029	\$ 4,739	\$ 2,502
Comprehensive income attributable to non-controlling interest	—	—	—	32
Comprehensive income attributable to ISG	\$ 3,217	\$ 2,029	\$ 4,739	\$ 2,470

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 6,529	\$ 552
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	2,075	2,640
Amortization of intangible assets	3,797	7,133
Deferred tax (benefit) expense from stock issuances	(152)	315
Amortization of deferred financing costs	600	739
Loss on sublease	—	578
Stock-based compensation	7,230	5,383
Changes in fair value of contingent consideration	362	145
Changes in accounts receivable allowance	501	398
Deferred tax provision (benefit)	(245)	(2,338)
Loss on disposal of fixed assets	32	23
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(5,778)	(10,424)
Prepaid expense and other assets	(26)	1,628
Accounts payable	509	(1,458)
Deferred revenue	(1,865)	(980)
Debt issuance costs	—	(38)
Accrued expenses	(2,415)	(1,023)
Net cash provided by operating activities	11,154	3,273
Cash flows from investing activities		
Acquisitions, net of cash acquired	—	(889)
Purchase of furniture, fixtures and equipment	(3,603)	(2,270)
Net cash used in investing activities	(3,603)	(3,159)
Cash flows from financing activities		
Principal payments on borrowings	(8,574)	(7,151)
Payment of the Alsbridge Notes	(7,000)	—
Proceeds from issuance of employee stock purchase plan shares	642	494
Installment payment for acquisitions	—	(543)
Payment of contingent consideration	(1,200)	(2,665)
Payments related to tax withholding for stock-based compensation	(2,743)	(2,174)
Equity securities repurchased	(2,879)	(2,853)
Net cash used in financing activities	(21,754)	(14,892)
Effect of exchange rate changes on cash	(710)	2,115
Net decrease in cash, cash equivalents, and restricted cash	(14,913)	(12,663)
Cash, cash equivalents, and restricted cash, beginning of period	28,514	34,982
Cash, cash equivalents, and restricted cash, end of period	\$ 13,601	\$ 22,319

Supplemental disclosures of cash flow information:

Non-cash investing and financing activities:

Issuance of treasury stock for vested restricted stock awards	\$ 5,151	\$ 6,437
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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”) was founded in 2006 with the strategic vision to become a high-growth, leading provider of information-based advisory services. In 2007, we consummated our initial public offering and completed the acquisition of TPI Advisory Services Americas, Inc. (“TPI”). In December 2017, we consummated our transformational acquisition of Alsbridge Holdings, Inc. (“Alsbridge”), a U.S.-based sourcing, automation and transformation advisory firm.

NOTE 2—BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017, 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 statement of the financial position of the Company as of September 30, 2018, the results of operations for the three and nine months ended September 30, 2018 and 2017 and the cash flows for the nine months ended September 30, 2018 and 2017. The condensed consolidated balance sheet as of December 31, 2017 has been derived from the Company’s audited consolidated financial statements. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

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, 2017, which are included in the Company’s 2017 Annual Report on Form 10-K filed with the SEC.

NOTE 3—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the periods reported. Actual results may differ from those estimates. Additionally, ISG has to determine the nature and timing of the satisfaction of performance obligations, the standalone selling price (“SSP”) of certain performance obligations, among other judgments associated with revenue recognition. Numerous internal and external factors can affect estimates. Estimates are also used for (but not limited to): allowance for doubtful accounts; useful lives of furniture, fixtures and equipment and definite-lived intangible assets; depreciation expense; fair value assumptions in analyzing goodwill and other long-lived assets for impairment; income taxes and deferred tax asset valuation; and the valuation of stock-based compensation.

Restricted Cash

Restricted cash consists of cash and cash equivalents which the Company has committed for rent deposits.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Fair Value

The carrying value of the Company's cash and cash equivalents, restricted cash, receivables, accounts payable, other current liabilities, and accrued interest approximated their fair values at September 30, 2018 and December 31, 2017 due to the short-term nature of these accounts.

Fair value measurements were applied with respect to our nonfinancial assets and liabilities measured on a nonrecurring basis, which would consist of measurements primarily to contingent consideration in a business combination.

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

- Level 1 measurements include unadjusted quoted market prices for identical assets or liabilities in an active market;
- Level 2 measurements include quoted market prices for identical assets or liabilities in an active market that have been adjusted for items such as effects of restrictions for transferability and those that are not quoted but are observable through corroboration with observable market data, including quoted market prices for similar assets; and
- Level 3 measurements include those that are unobservable and of a highly subjective measure.

The following tables summarize assets and liabilities measured at fair value on a recurring basis at the dates indicated:

	Basis of Fair Value Measurements			
	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	\$ 315	\$ —	\$ —	\$ 315
Total	\$ 315	\$ —	\$ —	\$ 315
Liabilities:				
Contingent consideration (1)	\$ —	\$ —	\$ 1,704	\$ 1,704
Total	\$ —	\$ —	\$ 1,704	\$ 1,704

	Basis of Fair Value Measurements			
	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	\$ 303	\$ —	\$ —	\$ 303
Total	\$ 303	\$ —	\$ —	\$ 303
Liabilities:				
Contingent consideration (1)	\$ —	\$ —	\$ 3,698	\$ 3,698
Total	\$ —	\$ —	\$ 3,698	\$ 3,698

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

(1) The short-term portion is included in “Accrued expenses.” The long-term portion is included in “Other liabilities.”

The fair value measurement of this contingent consideration is classified within Level 3 of the fair value hierarchy and reflects the Company’s own assumptions in measuring fair values using the income approach. In developing these estimates, the Company considered certain performance projections, historical results, and industry trends. This amount was estimated through a valuation model that incorporated probability-weighted assumptions related to the achievement of these milestones and the likelihood of the Company making payments. These cash outflow projections have then been discounted using a rate ranging from 14.5% to 28.5%.

The following table represents the change in the contingent consideration liability during the nine months ended September 30, 2018 and 2017:

	Nine Months Ended	
	September 30,	
	2018	2017
Beginning Balance	\$ 3,698	\$ 6,073
Payments of contingent consideration	(2,401)	(3,386)
Change in value of contingent consideration	362	145
Accretion of contingent consideration	44	1,030
Unrealized gain related to currency translation	1	28
Ending Balance	\$ 1,704	\$ 3,890

The Company’s financial instruments include outstanding borrowings of \$101.2 million at September 30, 2018 and \$116.7 million at December 31, 2017, which are carried at amortized cost. The fair value of debt is classified within Level 3 of the fair value hierarchy. The fair value of the Company's outstanding borrowings is approximately \$100.9 million and \$116.5 million at September 30, 2018 and December 31, 2017, respectively. The fair values of debt have been estimated using a discounted cash flow analysis based on the Company's incremental borrowing rate for similar borrowing arrangements. The incremental borrowing rate used to discount future cash flows ranged from 5.01% to 5.15%. The Company also considered recent transactions of peer group companies for similar instruments with comparable terms and maturities as well as an analysis of current market conditions.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued guidance on accounting for leases which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases and will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The guidance requires the use of a modified retrospective approach. The Company has less than fifty leases for which a corresponding asset and liability will be recorded on the balance sheet as of January 1, 2019. The adoption of this guidance will not have a material impact on our results of operations and will have no impact on our cash flows.

In August 2016, the FASB issued new guidance intended to reduce diversity in practice in how certain cash receipts and payments are classified in the statement of cash flows, including debt prepayment or extinguishment costs, the settlement of contingent liabilities arising from a business combination, proceeds from insurance settlements, and distributions from certain equity method investees. The guidance became effective for interim and annual periods beginning after December 15, 2017, and we adopted the guidance as of January 1, 2018. The guidance requires application using a retrospective transition method. The adoption of this guidance by the Company did not have a material impact on our results of operations.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

In August 2018, the FASB issued an update that modifies the disclosure requirements for fair value measurements by removing, modifying or adding disclosures. The guidance is effective for fiscal year beginning after December 15, 2019 and early adoption is permitted. Certain disclosures in the update are applied retrospectively, while others are applied prospectively. The Company is currently evaluating the potential impact of adopting this guidance on its financial statements.

In September 2018, the FASB issued new guidance which requires a customer in a cloud computing arrangement to determine which implementation costs to capitalize as assets or expense as incurred. Under the new guidance, capitalized implementation costs related to a hosting arrangement that is a service contract will be amortized over the term of the hosting arrangement, beginning when the module or component of the hosting arrangement is ready for its intended use. This update is effective for annual periods beginning after December 15, 2019, and interim periods within those periods, and early adoption is permitted. The Company is currently evaluating the potential impact of adopting this guidance on its financial statements.

NOTE 4—REVENUE

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (“ASC Topic 606”), “Revenue from Contracts with Customers”. ASC Topic 606 supersedes the revenue recognition requirements in ASC Topic 605, “Revenue Recognition” (“ASC Topic 605”), and requires the recognition of revenue upon transfer of control of promised services and products to clients in an amount that reflects the consideration we expect to receive in exchange for those services and products. We adopted ASC Topic 606 as of January 1, 2018 using the cumulative catch-up transition method. The most significant changes resulting from the adoption of ASC Topic 606, as previously disclosed in our 2017 Form 10-K, are as follows:

- For software and implementation contracts, revenue recognition on the software component will be accelerated to the point at which the software is installed, while revenue on the implementation component will be recognized over the software implementation period as a percentage of hours incurred to date as compared to the total expected hours.

For network contingency contracts with termination for convenience clauses, revenue will be recognized over time due to the existence of provisions for payment for progress incurred to date plus a reasonable profit margin.

- For managed service implementation contracts, revenue will be recognized over time as a percentage of hours incurred to date as compared to the total expected hours of the implementation.

We recognized the cumulative effect of applying the new revenue standard as an adjustment to the opening balance of retained earnings at the beginning of 2018. The comparative information has not been adjusted for the effect of ASC Topic 606 and continues to be reported under the accounting standards in effect for the periods presented. Upon the adoption of ASC Topic 606 on January 1, 2018, we recorded a net increase to opening retained earnings of \$2.0 million. The cumulative effect of the changes made to our Condensed Consolidated Balance Sheet as of January 1, 2018 for the adoption of ASC Topic 606 was as follows:

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

	As of January 1, 2018		
	As Previously Reported Under ASC 605	Adjustments	As Adjusted for ASC 606
Assets			
Accounts receivables and contract assets, net of allowance of \$503	\$ 70,824	\$ 1,468	\$ 72,292
Prepaid expenses and other current assets	\$ 4,467	\$ (1,071)	\$ 3,396
Deferred tax assets	\$ 2,521	\$ (549)	\$ 1,972
Liabilities			
Contract liabilities	\$ 8,898	\$ (2,418)	\$ 6,480
Accrued expenses	\$ 21,486	\$ 133	\$ 21,619
Deferred tax liabilities	\$ 1,569	\$ 95	\$ 1,664
Stockholders' equity			
Accumulated deficit	\$ (157,814)	\$ 2,038	\$ (155,776)

The majority of our revenue is derived from contracts that can span from a few months to several years. We enter into contracts that can include various combinations of services and products, which, depending on contract type, are sometimes capable of being distinct. If services are determined to be distinct, they are accounted for as separate performance obligations. A performance obligation is a promise in a contract to transfer a distinct good or service to the client and is the unit of account in ASC Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual services is not separately identifiable from other promises in the contracts and, therefore, not distinct. For contracts with multiple performance obligations, including our managed service implementation and software and implementation contract types, the Company allocates the transaction price to each performance obligation using our best estimate of the standalone selling price, or SSP, of each distinct good or service in the contract. As of September 30, 2018, the Company had \$89.4 million of remaining performance obligations, the majority of which are expected to be satisfied within the next year.

As part of our adoption of ASC Topic 606, we used practical expedients permitted by the standard when applicable. These practical expedients included:

- applying the new guidance only to contracts that are not completed as of January 1, 2018;
- expensing the incremental costs to obtain a contract as incurred when the expected amortization period is one year or less; and
- presenting all revenue net of any related sales tax.

Our contracts may include promises to transfer multiple services and products to a client. Determining whether services and products are considered distinct performance obligations that should be accounted for separately versus together may require judgment.

Estimates were required to determine the SSP for each distinct performance obligation identified within our managed service implementation contracts and software and implementation contracts. Further details of our approach to determining the SSP for each contract type is described below.

- For our software and implementation contracts, we had to determine the SSP for both the software license and implementation service performance obligations. For the software license performance obligation, we utilized

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

the adjusted market assessment approach and determined that our listed price of the software licenses generally approximated the SSP. For the implementation service performance obligation, we utilized the residual approach, which resulted in the difference between the total contract value and the software license price in the arrangement being allocated to the implementation service.

- For our managed service implementation contracts, we had to determine the SSP for both the managed services and implementation performance obligations. For each performance obligation, we estimated the SSP using the expected cost plus a reasonable profit margin approach, under which we forecasted our expected costs of satisfying a performance obligation and then added an appropriate margin for the distinct service.

Adjustments to Financial Statements from the Adoption of Accounting Pronouncements

The following table presents the effect of the adoption of ASC Topic 606 on our condensed consolidated balance sheet as of September 30, 2018.

	September 30, 2018		
	As Reported		
	Under ASC	Adjustments	ASC 605
	606		
Assets			
Accounts receivable and contract assets, net of allowance of \$770	\$ 76,403	\$ (4,305)	\$ 72,098
Prepaid expenses and other current assets	\$ 4,277	\$ 2,285	\$ 6,562
Deferred tax assets	\$ 2,997	\$ 549	\$ 3,546
Liabilities			
Contract liabilities	\$ 4,794	\$ 6,166	\$ 10,960
Accrued expenses	\$ 17,621	\$ (150)	\$ 17,471
Deferred tax liabilities	\$ 1,891	\$ (1,380)	\$ 511
Stockholders' equity			
Accumulated deficit	\$ (149,245)	\$ (6,107)	\$ (155,352)

The following table presents the effect of the adoption of ASC Topic 606 on our condensed consolidated statement of comprehensive income for the three months ended September 30, 2018.

	Three Months Ended September 30, 2018		
	As Reported Under		
	ASC 606	Adjustments	ASC 605
Revenues	\$ 67,965	\$ (2,620)	\$ 65,345
Operating expenses			
Direct costs and expenses for advisors	38,624	(211)	38,413
Selling, general and administrative	23,990	—	23,990
Depreciation and amortization	1,977	—	1,977
Operating income	3,374	(2,409)	965
Interest income	3	—	3
Interest expense	(1,675)	—	(1,675)
Foreign currency transaction loss	(6)	—	(6)
Income (loss) before taxes	1,696	(2,409)	(713)
Income tax benefit	(2,307)	(578)	(2,885)
Net income	\$ 4,003	\$ (1,831)	\$ 2,172

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

The following table presents the effect of the adoption of ASC Topic 606 on our condensed consolidated statement of comprehensive income for the nine months ended September 30, 2018.

	Nine Months Ended September 30, 2018		
	As Reported Under ASC 606	Adjustments	ASC 605
Revenues	\$ 207,868	\$ (6,587)	\$ 201,281
Operating expenses			
Direct costs and expenses for advisors	121,761	(1,230)	120,531
Selling, general and administrative	70,898	—	70,898
Depreciation and amortization	5,872	—	5,872
Operating income	9,337	(5,357)	3,980
Interest income	113	—	113
Interest expense	(5,140)	—	(5,140)
Foreign currency transaction gain	19	—	19
Income (loss) before taxes	4,329	(5,357)	(1,028)
Income tax benefit	(2,200)	(1,286)	(3,486)
Net income	\$ 6,529	\$ (4,071)	\$ 2,458

Contract Balances

The timing of revenue recognition, billings, and cash collections results in billed accounts receivables, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities). Our clients are billed based on the type of arrangement. A portion of our services is billed monthly based on hourly or daily rates. There are also client engagements in which we bill a fixed amount for our services. This may be one single amount covering the whole engagement or several amounts for various phases, functions, or milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. However, we sometimes receive advances or deposits, particularly on our software and implementation contracts, before revenue is recognized, resulting in contract liabilities. These assets and liabilities are reported on the consolidated balance sheet at the end of each reporting period. See the table below for a breakdown of contract assets and contract liabilities.

	September 30, 2018	January 1, 2018
		(as adjusted)
Contract assets (i.e., unbilled receivables)	\$ 30,680	\$ 18,838
Contract liabilities (i.e., deferred revenue)	\$ 4,794	\$ 6,480

Revenue recognized for the three months ended September 30, 2018 that was included in the contract liability balance at July 1, 2018 was \$4.2 million and represented primarily revenue from our software and implementation contracts and managed services contracts.

Revenue recognized for the nine months ended September 30, 2018 that was included in the contract liability balance at January 1, 2018 was \$6.2 million and represented primarily revenue from our software and implementation contracts and managed services contracts.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Disaggregation of Revenue

The following table presents our revenue disaggregated by geographic area for the three and nine months ended September 30, 2018.

Geographic area	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Americas	\$ 38,502	\$ 121,009
Europe	24,033	69,834
Asia Pacific	5,430	17,025
	\$ 67,965	\$ 207,868

NOTE 5—NET INCOME PER COMMON SHARE

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would share in the net income of the Company. For the three and nine months ended September 30, 2017, the effect of 34,374 stock appreciation rights (“SARs”) have not been considered in the diluted earnings per share, because the market price of the stock was less than the exercise price during the period in the computation, respectively. In addition, 2.5 million restricted shares have not been considered in the diluted earnings per share calculation for the nine months ended September 30, 2017, as the effect would be anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Basic:				
Net income attributable to ISG	\$ 4,003	\$ 1,428	\$ 6,529	\$ 520
Weighted average common shares	45,115	43,305	44,491	42,893
Earnings per share attributable to ISG	\$ 0.09	\$ 0.03	\$ 0.15	\$ 0.01
Diluted:				
Net income attributable to ISG	\$ 4,003	\$ 1,428	\$ 6,529	\$ 520
Interest expense of convertible debt, net of tax	—	2	—	6
Net income attributable to ISG, as adjusted	\$ 4,003	\$ 1,430	\$ 6,529	\$ 526
Basic weighted average common shares	45,115	43,305	44,491	42,893
Potential common shares	1,985	1,353	1,858	451
Diluted weighted average common shares	47,100	44,658	46,349	43,344
Diluted earnings per share attributable to ISG	\$ 0.08	\$ 0.03	\$ 0.14	\$ 0.01

NOTE 6—INCOME TAXES

The Company's effective tax rate for the three and nine months ended September 30, 2018 was (136.0)% and (50.8)% based on pretax income of \$1.7 million and \$4.3 million, respectively. The Company's effective tax rate for the quarter was less than the statutory rate primarily due to discrete tax benefits related to the release of a valuation allowance and the reversal of an uncertain tax position reserve. The effective tax rate was 14.1% and 527.9% for the three and nine months

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

ended September 30, 2017. The difference for the nine months ended September 30, 2018 was primarily due to the impact of current quarter earnings in jurisdictions where the Company is currently precluded from recording a tax provision, the release of accruals for uncertain tax positions of \$1.7 million due to the expiration of statute of limitations in a foreign and U.S. jurisdictions and \$1.3 million due to Company establishing its position on foreign source income component of its U.S. foreign tax credit claims, as well as the release of \$1.3 million of valuation allowance against U.S. foreign tax credit positions, during the nine months ended September 30, 2018. The difference for the three months ended September 30, 2018 was primarily due to the reversals of \$2.3 million of accruals for these uncertain tax positions and the \$1.3 million of valuation allowance release related to foreign tax credits.

As of September 30, 2018, the Company had total unrecognized tax benefits of approximately \$1.4 million all of which would impact the Company's effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax provision in its condensed consolidated statement of operations. As of September 30, 2018, the Company's accrual of interest and penalties amounted to \$0.7 million. The Company recorded no material year-to-date change in the accrual of unrecognized tax benefits and associated interest and penalties.

NOTE 7—COMMITMENTS AND CONTINGENCIES

The Company is subject to contingencies which arise through the ordinary course of business. All material liabilities of which management were aware are properly reflected in the financial statements at September 30, 2018 and December 31, 2017.

Saugatuck Contingent Consideration

During the quarter ended September 30, 2018, the Company reversed the remaining \$0.3 million contingent consideration liability related to the acquisition of Saugatuck as the related earn-out payment is no longer expected. The Company paid \$0.3 million in April 2018 related to 2017 performance, of which 50% was paid with shares of ISG common stock.

Experton Contingent Consideration

As of September 30, 2018, the Company has recorded a liability of \$0.3 million representing the estimated fair value of contingent consideration related to the acquisition of Experton which is classified as current and included in accrued expenses on the consolidated balance sheet. The Company paid \$0.5 million in April 2018 related to 2017 performance, of which 50% was paid with shares of ISG common stock.

TracePoint Contingent Consideration

As of September 30, 2018, the Company has recorded a liability of \$1.4 million representing the estimated fair value of contingent consideration related to the acquisition of TracePoint which is classified as current and included in accrued expenses on the consolidated balance sheet. The Company paid \$1.6 million in April 2018 related to 2017 performance, of which 50% was paid with shares of ISG common stock.

NOTE 8—SEGMENT AND GEOGRAPHICAL INFORMATION

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

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Geographical revenue information for the segment is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
Americas	\$ 38,502	\$ 41,524	\$ 121,009	\$ 122,581
Europe	24,033	19,732	69,834	61,443
Asia Pacific	5,430	7,093	17,025	18,918
	\$ 67,965	\$ 68,349	\$ 207,868	\$ 202,942

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 or by service line for the purposes of making operating decisions or allocating resources.

NOTE 9—FINANCING ARRANGEMENTS AND LONG-TERM DEBT

On December 1, 2016, the Company entered into an amended and restated senior secured credit facility (as amended from time to time, the “2016 Credit Agreement”) comprised of a \$110.0 million term facility and a \$30.0 million revolving facility, amending and restating its senior secured credit facility originally entered into on May 3, 2013. The material terms of the 2016 Credit Agreement are as follows:

- Each of the term loan facility and revolving credit facility has a maturity date of December 1, 2021 (the “Maturity Date”).
- The credit facility is secured by all of the equity interests owned by the Company, and its direct and indirect domestic subsidiaries and, subject to agreed exceptions, the Company’s direct and indirect “first-tier” foreign subsidiaries and a perfected first priority security interest in all of the Company’s and its direct and indirect domestic subsidiaries’ tangible and intangible assets.

- The Company's direct and indirect existing and future wholly-owned domestic subsidiaries serve as guarantors to the Company's obligations under the senior secured facility.
 - At the Company's option, the credit facility bears interest at a rate per annum equal to either (i) the "Base Rate" (which is the highest of (a) the rate publicly announced from time to time by the administrative agent as its "prime rate", (b) the Federal Funds Rate plus 0.5% per annum and (c) the Eurodollar Rate, plus 1.0%), plus the applicable margin (as described below) or (ii) Eurodollar Rate (adjusted for maximum reserves) as determined by the Administrative Agent, plus the applicable margin. The applicable margin is adjusted quarterly based upon the Company's quarterly leverage ratio and ranges from 3.5% to 1.75% for the Eurodollar Rate and 2.5% to 0.75% for the Base Rate.
- The Term Loan is repayable in four consecutive quarterly installments of \$1,375,000 each, commencing March 31, 2017, followed by eight consecutive quarterly installments in the amount of \$2,062,500 each, commencing March 31, 2018, followed by seven consecutive quarterly installments of \$2,750,000 each, commencing March 31, 2020 and a final payment of the remaining outstanding principal amount of the Term Loan on the Maturity Date.
- Mandatory repayments of term loans shall be required from (subject to certain agreed exceptions) (i) 100% of the proceeds from asset sales by the Company and its subsidiaries, (ii) 100% of the net proceeds from issuances of

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

debt and equity by the Company and its subsidiaries, and (iii) 100% of the net proceeds from insurance recovery and condemnation events of the Company and its subsidiaries.

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

On February 10, 2017, as required by the 2016 Credit Agreement, the Company entered into an agreement to cap the interest rate at 4% on the LIBOR component of its borrowings under the term loan facility until December 31, 2019. This interest rate cap was not designated for hedging or speculative purposes. The expense related to this interest rate cap was not material.

As of September 30, 2018, the total principal outstanding under the term loan facility and revolving credit facility was \$97.2 million and \$4.0 million, respectively. The Company paid \$7.3 million related to the term loan facility and \$1.0 million related to the revolving credit facility during the nine months ended September 30, 2018. As of September 30, 2018, the debt issuance cost was \$1.8 million. The effective interest rate for the term loan facility and revolving credit facility as of September 30, 2018 was 5.1% and 5.0%, respectively.

Compass Convertible Notes

On January 4, 2011, as part of the consideration for the acquisition of Compass, we issued an aggregate of \$6.3 million in convertible notes to Compass (the "Compass Notes"). The Compass Notes matured on January 4, 2018 and interest was 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 Compass Notes. The Compass Notes were subject to transfer restrictions until January 31, 2013. If the price of our common stock on the Nasdaq Global Market

exceeded \$4 per share for 60 consecutive trading days (the “Trigger Event”), the holder of the Compass Notes could convert all (but not less than all) of the outstanding principal amount of the Compass Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger Event, we could prepay all or any portion of the outstanding principal amount of the Compass Notes by giving the holder 30 days written notice. On March 21, 2014, the Trigger Event occurred. As a result, a holder of the Compass Notes could convert all (but not less than all) of the outstanding principal amount of the Compass Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. In addition, ISG could elect to prepay all or any portion of the outstanding principal amount of the Compass Notes by giving a holder 30 days written notice; however, such holder had to be given the opportunity to convert the outstanding principal amount into shares as described above. No holder of the Compass Notes had the option to require cash payment as a result of the Trigger Event.

In 2013 and 2016, we prepaid substantial portions of the outstanding principal amount of the Compass Notes. On January 4, 2018, we paid off the \$0.2 million remaining on the Compass Notes.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

Alsbridge Notes

On December 1, 2016, as part of the merger consideration for the acquisition of Alsbridge, we issued an aggregate of \$7.0 million in unsecured subordinated promissory notes (the "Alsbridge Notes"). The Alsbridge Notes accrued interest on the principal amount daily at a rate of 2.0%. At maturity, on September 4, 2018, we paid off the full \$7.0 million of principal and \$0.2 million of interest outstanding under the Alsbridge Notes

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

You should read the following discussion and analysis in conjunction with our financial statements and related notes included elsewhere in this report. Except for historical information, the discussion in this report contains certain forward-looking statements that involve risks and uncertainties. We have based these forward-looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward-looking statements by terminology, such as “may,” “should,” “could,” “predict,” “potential,” “continue,” “expect,” “anticipate,” “future,” “plan,” “believe,” “estimate,” “forecast” and similar expressions (or the negative of such expressions.) Forward-looking statements include statements concerning 2018 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 2017 Annual Report on Form 10-K titled “Risk Factors.”

BUSINESS OVERVIEW

ISG (Information Services Group) (“ISG”) (Nasdaq: III) is a leading global technology research and advisory firm. A trusted business partner to more than 700 clients, including 75 of the top 100 enterprises in the world, ISG is committed to helping corporations, public sector organizations, and service and technology providers achieve operational excellence and faster growth. The firm specializes in digital transformation services, including automation, cloud and data analytics; sourcing advisory; managed governance and risk services; network carrier services; technology strategy and operations design; change management; market intelligence and technology research and analysis. Founded in 2006, and based in Stamford, Conn., ISG employs approximately 1,300 professionals operating in more than 20 countries—a global team known for its innovative thinking, market influence, deep industry and technology expertise, and world-class research and analytical capabilities based on our comprehensive marketplace data.

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

We derive our revenues from fees and reimbursable expenses for professional services. A portion of our revenues are generated under hourly or daily rates billed on a time and expense basis. Clients are typically invoiced on a monthly basis, with revenue recognized as the services are provided. There are also client engagements in which we are paid a fixed amount for our services, often referred to as fixed fee billings. This may be one single amount covering the whole engagement or several amounts for various phases or functions. From time to time, we also earn incremental revenues, in addition to hourly or fixed fee billings, which are contingent on the attainment of certain contractual milestones or objectives. Such revenues may cause unusual variations in quarterly revenues and operating results. We also derive our revenues from recurring revenue streams. This includes Managed Services, Research, the U.S. Public Sector, subscription services around Robotic Process Automation (“RPA”) and analytic benchmarking. All are characterized by subscriptions (i.e., renewal centric as opposed to project centric revenue streams) or multi-year contracts. Our digital services now span a volume of offerings and have become embedded as part of even our more traditional transaction services. Digital enablement provides capabilities, digital insights and better engagement with clients and partners.

Our results are impacted principally by our full-time consultants’ utilization rate, the number of business days in each quarter and the number of our revenue generating professionals who are available to work. Our utilization rate can be negatively affected by increased hiring because there is generally a transition period for new professionals that result in a

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

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

Revenues

Revenues are generally derived from fixed fee contracts as well as engagements priced on a time and materials basis which are recorded based on actual time worked as the services are performed. In addition, from time to time, we also earn incremental revenues, in addition to hourly or fixed fee billings, which are contingent on the attainment of certain contractual milestones. 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 separately or as part of the overall fee arrangement. Invoices are issued to clients monthly, semimonthly or in accordance with the specific contractual terms of each project.

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

Geographical revenue information for the segment is as follows:

Geographic Area	Three Months Ended September 30,			Percent	
	2018	2017	Change	Change	
	(in thousands)				
Americas	\$ 38,502	\$ 41,524	\$ (3,022)	(7)	%
Europe	24,033	19,732	4,301	22	%

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Asia Pacific	5,430	7,093	(1,663)	(23)	%
Total revenues	\$ 67,965	\$ 68,349	\$ (384)	(1)	%

Revenues decreased \$0.4 million or approximately 1% in the third quarter of 2018. The decrease in revenues in the Americas was primarily attributable to decline in our Advisory service lines. The increase in revenues in Europe was primarily attributable to growth in our Advisory service line. The decrease in revenues in Asia Pacific was primarily attributable to a decline in our Managed Services service line. The translation of foreign currency revenues into U.S. dollars negatively impacted performance compared to the prior year in Europe and Asia Pacific.

Operating Expenses

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

Operating Expenses	Three Months Ended September 30,			Percent	
	2018	2017	Change	Change	
	(in thousands)				
Direct costs and expenses for advisors	\$ 38,624	\$ 38,214	\$ 410	1	%
Selling, general and administrative	23,990	23,710	280	1	%
Depreciation and amortization	1,977	2,951	(974)	(33)	%
Total operating expenses	\$ 64,591	\$ 64,875	\$ (284)	—	%

Total operating expenses decreased \$0.3 million for the quarter with decreases in depreciation and amortization offset by increases in direct costs and expenses for advisors and selling, general and administrative (“SG&A”) expenses. The increases in direct costs and SG&A were primarily due to higher: license expense of \$0.9 million, stock compensation of \$0.7 million, travel expenses of \$0.6 million, tax indemnity receivable of \$0.5 million, professional fees of \$0.4 million, acquisition-related costs of \$0.3 million and contract labor expenses of \$0.2 million. These cost increases were primarily offset by lower: compensation and benefits of \$2.0 million and contingent consideration liability of \$1.1 million.

Compensation costs consist of a mix of fixed and variable salaries, annual bonuses, benefits and profit sharing 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 profit sharing 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 ISG Index and assembling proposals.

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

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

Depreciation and amortization expense in the third quarter of 2018 and 2017 was \$2.0 million and \$2.9 million, respectively. The decrease of \$0.9 million in depreciation and amortization expense was primarily due to prior year intangible assets that are now fully amortized. Our fixed assets consist of furniture, fixtures, equipment (mainly personal computers) and leasehold improvements. Depreciation expense is generally computed by applying the straight-line method over the estimated useful lives of assets. We also capitalize certain costs associated with the purchase and development of internal-use software, system conversions and website development costs. These costs are amortized over the estimated useful life of the software or system.

We amortize our intangible assets (e.g. client relationships and databases) over their estimated useful lives. Goodwill related to acquisitions is not amortized, but is subject to annual impairment testing.

Other Income (Expense), Net

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

	Three Months Ended September 30,			Percent	
	2018	2017	Change	Change	
	(in thousands)				
Interest income	\$ 3	\$ 15	\$ (12)	(80)	%
Interest expense	(1,675)	(1,716)	41	2	%
Foreign currency loss	(6)	(111)	105	95	%
Total other income (expense), net	\$ (1,678)	\$ (1,812)	\$ 134	7	%

The total decrease of \$0.1 million was primarily the result of lower interest expense attributable to our lower debt balance.

Income Tax Expense

Our quarterly effective tax rate varies from period to period based on the mix of earnings among the various state and foreign tax jurisdictions in which business is conducted and the level of non-deductible expenses projected to be incurred during the current fiscal year. Our effective tax rate for the three months ended September 30, 2018 was (136.0)% compared to 14.1% for the three months ended September 30, 2017. The difference was primarily due to the impact of current quarter earnings in jurisdictions where the Company is currently precluded from booking a tax provision for the three months ended September 30, 2018, the release of \$2.3 million of accruals for uncertain tax positions due to the expiration of statute limitations in a foreign jurisdiction, and reversal of \$1.3 million of valuation allowance established against U.S. foreign tax credit positions during the three months ended September 30, 2018.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

Revenues

Geographical revenue information for the segment is as follows:

Geographic Area	Nine Months Ended September 30,			Percent	
	2018 (in thousands)	2017	Change	Change	
Americas	\$ 121,009	\$ 122,581	\$ (1,572)	(1)	%
Europe	69,834	61,443	8,391	14	%
Asia Pacific	17,025	18,918	(1,893)	(10)	%
Total revenues	\$ 207,868	\$ 202,942	\$ 4,926	2	%

Revenues increased \$4.9 million or approximately 2% for the nine months ended September 30, 2018. The increase in revenues in Europe was primarily attributable to growth in our Advisory service line. The decrease in revenues in the Americas was primarily attributable to a decline in our Advisory service line partially offset by growth attributable to our Managed Services service line. The decrease in revenues in Asia Pacific was primarily attributable to a decline in our Managed Services service line. The translation of foreign currency revenues into U.S. dollars favorably impacted performance compared to the prior year in Europe and Asia Pacific.

Operating Expenses

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

Operating Expenses	Nine Months Ended September 30,			Percent	
	2018 (in thousands)	2017	Change	Change	
Direct costs and expenses for advisors	\$ 121,761	\$ 119,153	\$ 2,608	2	%
Selling, general and administrative	70,898	68,815	2,083	3	%
Depreciation and amortization	5,872	9,773	(3,901)	(40)	%
Total operating expenses	\$ 198,531	\$ 197,741	\$ 790	—	%

Total operating expenses increased \$0.8 million for 2018 with increases in direct costs and expenses for advisors and SG&A expenses partially offset by a decrease in depreciation and amortization. The increases in SG&A and direct costs and expenses for advisors were due primarily to higher: license expense of \$3.0 million, stock compensation of \$1.8 million, travel expense of \$1.3 million, compensation and benefits of \$1.2 million, professional fees of \$1.1 million, tax indemnity receivable of \$0.5 million and occupancy expense of \$0.4 million. These cost increases were partially offset primarily by lower: contract labor costs of \$3.0 million, severance and integration expenses of \$1.1 million, acquisition-related costs of \$0.9 million and contingent consideration liability of \$0.7 million.

Depreciation and amortization expense in 2018 and 2017 were \$5.9 million and \$9.8 million, respectively. The decrease of \$3.9 million in depreciation and amortization expense was primarily due to prior year intangible assets that are now fully amortized.

Other Income (Expense), Net

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

	Nine Months Ended September 30,			Percent
	2018	2017	Change	Change

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	(in thousands)				
Interest income	\$ 113	\$ 94	\$ 19	20	%
Interest expense	(5,140)	(5,132)	(8)	—	%
Foreign currency gain (loss)	19	(292)	311	107	%
Total other income (expense), net	\$ (5,008)	\$ (5,330)	\$ 322	6	%

The total decrease of \$0.3 million was primarily the result of a net foreign currency gain.

Income Tax Expense

Our effective tax rate for the nine months ended September 30, 2018 was (50.8)% compared to 527.9% for the nine months ended September 30, 2017. The difference for the nine months ended September 30, 2018 was primarily due to the impact of current quarter earnings in jurisdictions where the Company is currently precluded from recording a tax provision, the release of accruals for uncertain tax positions of \$1.7 million due to the expiration of statute of limitations in a foreign and U.S. jurisdictions and \$1.3 million due to Company establishing its position on foreign source income component of its U.S. foreign tax credit claims, as well as the release of \$1.3 million of valuation allowance against U.S. foreign tax credit positions, during the nine months ended September 30, 2018.

NON-GAAP FINANCIAL PRESENTATION

This management's discussion and analysis presents supplemental measures of our performance that are derived from our consolidated financial information but are not presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"). We refer to these financial measures, which are considered "non-GAAP financial measures" under SEC rules, as adjusted EBITDA, adjusted net income, and adjusted earnings per diluted share, each as defined below. See "Non-GAAP Financial Measures" below for information about our use of these non-GAAP financial measures, including our reasons for including these measures and reconciliations of each non-GAAP financial measure to the most directly comparable GAAP financial measure.

NON-GAAP FINANCIAL MEASURES

We use non-GAAP financial measures to supplement the financial information presented on a GAAP basis. We provide adjusted EBITDA (defined as net income before net income attributable to non-controlling interest, plus interest, taxes, depreciation and amortization, foreign currency transaction gains/losses, non-cash stock compensation, change in contingent consideration, acquisition-related costs, tax indemnity receivable, severance and integration expense), adjusted net income (defined as net income plus amortization of intangible assets, non-cash stock compensation, foreign currency transaction gains/losses, change in contingent consideration, acquisition-related costs, severance and integration expense, on a tax-adjusted basis) and adjusted net income as earnings per diluted share, excluding the net of tax effect of the items set forth in the table below. These are non-GAAP measures that the Company believes provide useful information to both management and investors by excluding certain expenses and financial implications of foreign currency translations, which management believes are not indicative of ISG's core operations. These non-GAAP measures are used by the Company to evaluate the Company's business strategies and management's performance. These non-GAAP financial measures exclude non-cash and certain other special charges that many investors believe may obscure the user's overall understanding of the Company's current financial performance and the Company's prospects for the future. We believe that these non-GAAP measures provide useful information to investors because they improve the comparability of the financial results between periods and provide for greater transparency of key measures used to evaluate the Company's performance.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2017	2017	2017
	(in thousands)			
Net income attributable to ISG	\$ 4,003	\$ 1,428	\$ 6,529	\$ 520
Net income attributable to non-controlling interest	—	—	—	32
Interest expense (net of interest income)	1,672	1,701	5,027	5,038

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Income taxes	(2,307)	234	(2,200)	(681)
Depreciation and amortization	1,977	2,951	5,872	9,773
Change in contingent consideration liabilities	(668)	415	378	1,108
Acquisition-related costs(1)	280	89	280	1,186
Severance and integration expense	332	356	439	1,514
Tax indemnity receivable	931	454	931	454
Foreign currency transaction loss (gain)	6	111	(19)	292
Non-cash stock compensation	2,585	1,873	7,230	5,383
Adjusted EBITDA	\$ 8,811	\$ 9,612	\$ 24,467	\$ 24,619

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Net income attributable to ISG	\$ 4,003	\$ 1,428	\$ 6,529	\$ 520
Non-cash stock compensation	2,585	1,873	7,230	5,383
Intangible amortization	1,259	2,382	3,797	7,133
Change in contingent consideration liabilities	(668)	415	378	1,108
Acquisition-related costs(1)	280	89	280	1,186
Severance and integration expense	332	356	439	1,514
Foreign currency transaction loss (gain)	6	111	(19)	292
Tax effect (2)	(1,214)	(1,986)	(3,874)	(6,314)
Adjusted net income	\$ 6,583	\$ 4,668	\$ 14,760	\$ 10,822

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss) per diluted share attributable to ISG	\$ 0.08	\$ 0.03	\$ 0.14	\$ 0.01
Non-cash stock compensation	0.05	0.04	0.16	0.12
Intangible amortization	0.03	0.05	0.08	0.16
Change in contingent consideration liabilities	(0.01)	0.01	0.01	0.03
Acquisition-related costs(1)	0.01	0.00	0.01	0.03
Severance and integration expense	0.01	0.01	0.01	0.03
Foreign currency transaction loss (gain)	0.00	0.00	0.00	0.01
Tax effect(2)	(0.03)	(0.04)	(0.09)	(0.14)
Adjusted net income per diluted share	\$ 0.14	\$ 0.10	\$ 0.32	\$ 0.25

(1) Consists of expenses from acquisition-related costs and non-cash fair value adjustments on pre-acquisition deferred revenues.

(2) Marginal tax rate of 32% and 38% applied, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

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

As of September 30, 2018, our cash, cash equivalents and restricted cash were \$13.6 million, a net decrease of \$14.9 million from December 31, 2017, which was primarily attributable to the following:

- net cash provided by operating activities of \$11.2 million;
- payments of principal amounts under our Credit Agreement of \$8.3 million;
- full payment of the Alsbridge Notes of \$7.0 million;

- payments of contingent consideration of \$1.2 million;
- capital expenditures for furniture, fixtures and equipment of \$3.6 million;
- equity repurchases of \$2.9 million; and
- payments of \$2.7 million related to tax withholding for stock-based compensation.

Capital Resources

On December 1, 2016, the Company entered into an amended and restated senior secured credit facility (as amended from time to time, the “2016 Credit Agreement”) comprised of a \$110.0 million term facility and a \$30.0 million revolving facility, amending and restating its senior secured credit facility originally entered into on May 3, 2013. The material terms of the 2016 Credit Agreement are as follows:

- Each of the term loan facility and revolving credit facility has a maturity date of December 1, 2021 (the “Maturity Date”).
- The credit facility is secured by all of the equity interests owned by the Company, and its direct and indirect domestic subsidiaries and, subject to certain agreed exceptions, the Company’s direct and indirect “first-tier” foreign subsidiaries and a perfected first priority security interest in all of the Company’s and its direct and indirect domestic subsidiaries’ tangible and intangible assets.
- The Company’s direct and indirect existing and future wholly-owned domestic subsidiaries serve as guarantors to the Company’s obligations under the senior secured facility.
 - At the Company’s option, the credit facility bears interest at a rate per annum equal to either (i) the “Base Rate” (which is the highest of (a) the rate publicly announced from time to time by the administrative agent as its “prime rate”, (b) the Federal Funds Rate plus 0.5% per annum and (c) the Eurodollar Rate, plus 1.0%), plus the applicable margin (as described below) or (ii) Eurodollar Rate (adjusted for maximum reserves) as determined by the Administrative Agent, plus the applicable margin. The applicable margin

is adjusted quarterly based upon the Company's quarterly leverage ratio and ranges from 3.5% to 1.75% for the Eurodollar Rate and 2.5% to 0.75% for the Base Rate.

- The Term Loan is repayable in four consecutive quarterly installments of \$1,375,000 each, commencing March 31, 2017, followed by eight consecutive quarterly installments in the amount of \$2,062,500 each, commencing March 31, 2018, followed by seven consecutive quarterly installments of \$2,750,000 each, commencing March 31, 2020 and a final payment of the remaining outstanding principal amount of the Term Loan on the Maturity Date.
 - Mandatory repayments of term loans shall be required from (subject to agreed exceptions) (i) 100% of the proceeds from asset sales by the Company and its subsidiaries, (ii) 100% of the net proceeds from issuances of debt and equity by the Company and its subsidiaries, and (iii) 100% of the net proceeds from insurance recovery and condemnation events of the Company and its subsidiaries.
- The senior secured credit facility contains a number of covenants that, among other things, place restrictions on matters customarily restricted in senior secured credit facilities, including restrictions on indebtedness (including guarantee obligations), liens, fundamental changes, sales or disposition of property or assets, investments (including loans, advances, guarantees and acquisitions), transaction with affiliates, dividends and other payments in respect of capital stock, optional payments and modifications of other material debt instruments, negative

pledges and agreements restricting subsidiary distributions and changes in line of business. In addition, the Company is required to comply with a total leverage ratio and a fixed charge coverage ratio.

- The senior secured credit facility contains customary events of default, including cross-default to other material agreements, judgment default and change of control.

On February 10, 2017, as required by the 2016 Credit Agreement, the Company entered into an agreement to cap the interest rate at 4% on the LIBOR component of its borrowings under the term loan facility until December 31, 2019. This interest rate cap was not designated for hedging or speculative purposes. The expense related to this interest rate cap was not material.

As of September 30, 2018, the total principal outstanding under the term loan facility and revolving credit facility was \$97.2 million and \$4.0 million, respectively. The Company paid \$7.3 million related to the term loan facility and \$1.0 million related to the revolving credit facility during the nine months ended September 30, 2018. As of September 30, 2018, the debt issuance cost was \$1.8 million. The effective interest rate for the term loan facility and revolving credit facility as of September 30, 2018 was 5.1% and 5.0%, respectively.

Compass Convertible Notes

On January 4, 2011, as part of the consideration for the acquisition of Compass, we issued an aggregate of \$6.3 million in convertible notes to Compass (the “Compass Notes”). The Compass Notes matured on January 4, 2018 and interest was 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 Compass Notes. The Compass Notes were subject to transfer restrictions until January 31, 2013. If the price of our common stock on the Nasdaq Global Market exceeded \$4 per share for 60 consecutive trading days (the “Trigger Event”), the holder of the Compass Notes could convert all (but not less than all) of the outstanding principal amount of the Compass Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger Event, we could prepay all or any portion of the outstanding principal amount of the Compass Notes by giving the holder 30 days written notice. On March 21, 2014, the Trigger Event occurred. As a result, a holder of the Compass Notes could convert all (but not less than all) of the outstanding principal amount of the Compass Notes into shares of our common stock at the rate of 1 share for every \$4 in principal amount outstanding. In addition, ISG could elect to prepay all or any portion of the outstanding principal amount of the Compass Notes by giving a holder 30 days written notice; however, such holder had to be given the opportunity to convert the outstanding principal amount into shares as described above. No holder of the Compass Notes had the option to require cash payment as a result of the Trigger Event.

In 2013 and 2016, we prepaid substantial portions of the outstanding principal amount of the Compass Notes. On January 4, 2018, we paid off the \$0.2 million remaining on the Compass Notes.

Alsbridge Notes

On December 1, 2016, as part of the merger consideration for the acquisition of Alsbridge, we issued an aggregate of \$7.0 million in unsecured subordinated promissory notes (the "Alsbridge Notes"). The Alsbridge Notes accrued interest on the principal amount daily at a rate of 2.0%. At maturity, on September 4, 2018, we paid off the full \$7.0 million of principal and \$0.2 million of interest outstanding under the Alsbridge Notes.

Off-Balance Sheet Arrangements

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

Recently Issued Accounting Pronouncements

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

Critical Accounting Policies and Accounting Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements. We prepare these financial statements in conformity with U.S. generally accepted accounting principles. As such, we are required to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. We base our estimates on historical experience, available information and various other assumptions we believe to be reasonable under the circumstances. On an on-going basis, we evaluate our estimates; however, actual results may differ from these estimates under different assumptions or conditions. There have been no material changes or developments in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our Annual Report on Form 10-K, for the year ended December 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest Rate Risk

We are exposed to financial market risks primarily related to changes in interest rates associated with our borrowing and investing activities. A 100 basis point change in interest rates would result in an annual change in the results of operations of \$1.0 million pre-tax.

Foreign Currency Risk

We operate in a number of international areas which exposes us to foreign currency exchange rate risk. We have significant international revenue, which is predominantly collected in local currency. It is expected that our international revenues will continue to grow as European, Asian and other markets adopt sourcing solutions. The translation of our revenues into U.S. dollars, as well as our costs of operating internationally, may adversely affect our

business, results of operations and financial condition. A measure of the potential impact of foreign currency translation can be determined through a sensitivity analysis of our cash and cash equivalents. At September 30, 2018, we had \$13.5 million of cash and cash equivalents, with a substantial portion denominated in foreign currencies. If the exchange rates of the foreign currencies we hold all increased or decreased in comparison to the U.S. dollar by 10%, the amount of cash and cash equivalents we would have reported on September 30, 2018 would have correspondingly increased or decreased by approximately \$0.9 million. The translation of our foreign currency revenues and expenses historically has not had a material impact on our consolidated earnings since movements in and among the major currencies in which we operate tend to impact our revenues and expenses equally.

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

Credit Risk

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

Our 25 largest clients accounted for approximately 39% of revenue in 2017 and 38% in 2016. If one or more of our large clients terminate or significantly reduce their engagements or fail to remain a viable business, then our revenues could be materially and adversely affected. In addition, our large clients generally maintain sizable receivable balances at

any given time and our ability to collect such receivables could be jeopardized if such client fails to remain a viable business.

ITEM 4.CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 as amended (the “Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2018, as required by the Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2018.

Internal Control Over Financial Reporting

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

PART II - OTHER INFORMATION

ITEM 1.LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

The risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 have not materially changed.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The following table details the repurchases that were made during the three months ended September 30, 2018.

Period	Total Number of Securities Purchased (In thousands)	Average Price per Securities	Total Numbers of Securities Purchased as Part of Publicly Announced Plan (In thousands)	Approximate Dollar Value of Securities That May Yet Be Purchased Under The Plan (In thousands)
July 1 – July 31	69	\$ 4.10	69	\$ 12,417
August 1 – August 31	12	\$ 4.07	12	\$ 12,369
September 1 – September 30	3	\$ 4.95	3	\$ 12,354

ITEM 6.EXHIBITS

The following exhibits are filed as part of this report:

Exhibit

Number	Description
31.1	* <u>Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).</u>
31.2	* <u>Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).</u>
32.1	* <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	* <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101	* The following materials from ISG's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheet, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows and (iv) the Notes to Consolidated Financial Statements.

*Filed herewith.

28

SIGNATURES

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

INFORMATION SERVICES GROUP, INC.

Date: November 9, 2018 /s/ Michael P. Connors
Michael P. Connors, Chairman of the
Board and Chief Executive Officer

Date: November 9, 2018 /s/ David E. Berger
David E. Berger, Executive Vice
President and Chief Financial Officer