Information Services Group Inc.
Form 10-Q
August 08, 2016

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 June 30, 2016

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.)

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 No

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

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

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

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

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

Class	Outstanding at July 29, 2016
Common Stock, $0.001 par value	35,694,703 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,” “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)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$ 16,081	$ 17,835
Accounts and unbilled receivables, net of allowance of $569 and $415, respectively	52,580	49,484
Deferred tax asset	2,078	2,109
Prepaid expense and other current assets	2,557	2,066
Total current assets	73,296	71,494
Restricted cash	334	394
Furniture, fixtures and equipment, net	3,222	3,021
Goodwill	42,096	37,286
Intangible assets, net	13,042	13,860
Other assets	5,399	4,704
Total assets	$ 137,389	$ 130,759
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 8,223	$ 6,700
Current maturities of long-term debt	2,250	2,250
Deferred revenue	4,221	5,154
Accrued expenses	18,696	17,076
Total current liabilities	33,390	31,180
Long-term debt, net of current maturities	57,036	47,947
Other liabilities	6,302	4,521
Total liabilities	96,728	83,648
Commitments and contingencies (Note 7)		
Redeemable noncontrolling interest	1,076	939
Stockholders' equity		
Preferred stock, $.001 par value; 10,000 shares authorized; none issued	—	—
Common stock, $.001 par value, 100,000 shares authorized; 38,003 shares issued and 35,510 outstanding at June 30, 2016 and 37,977 shares issued and 37,219 outstanding at December 31, 2015	38	38

Additional paid-in capital	204,414	204,904
Treasury stock (2,493 and 758 common shares, respectively, at cost)	(9,954)	(3,053)
Accumulated other comprehensive loss	(6,647)	(6,538)
Accumulated deficit	(148,266)	(149,179)
Total stockholders’ equity	39,585	46,172
Total liabilities, redeemable noncontrolling interest and stockholders’ equity	$ 137,389	$ 130,759

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	$ 60,354	$ 53,411	$ 110,283	$ 103,950
Operating expenses				
Direct costs and expenses for advisors	36,106	32,558	67,474	62,996
Selling, general and administrative	19,104	17,011	35,815	33,421
Depreciation and amortization	1,927	1,838	3,645	3,556
Operating income	3,217	2,004	3,349	3,977
Interest income	2	7	24	9
Interest expense	(566)	(440)	(994)	(938)
Foreign currency transaction gain (loss)	244	26	(262)	400
Income before taxes	2,897	1,597	2,117	3,448
Income tax provision	1,234	578	1,105	1,522
Net income	$ 1,663	$ 1,019	$ 1,012	$ 1,926
Net income attributable to noncontrolling interest	51	85	99	139
Net income attributable to ISG	$ 1,612	$ 934	$ 913	$ 1,787
Weighted average shares outstanding:				
Basic	35,609	37,199	36,475	37,116
Diluted	36,719	38,971	37,029	38,731
Earnings per share attributable to ISG:				
Basic	$ 0.05	$ 0.03	$ 0.03	$ 0.05
Diluted	$ 0.04	$ 0.02	$ 0.03	$ 0.05
Comprehensive income:				
Net income	$ 1,663	$ 1,019	$ 1,012	$ 1,926
Foreign currency translation, net of tax benefit (expense) of $456, $(315), $66 and $630, respectively.	(745)	197	(109)	(1,242)
Comprehensive income	918	$ 1,216	903	$ 684
Comprehensive income attributable to noncontrolling interest	51	85	99	139
Comprehensive income attributable to ISG	$ 867	$ 1,131	$ 804	$ 545

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, 2016	2015
Cash flows from operating activities		
Net income	$ 1,012	$ 1,926
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation expense	988	903
Amortization of intangible assets	2,657	2,653
Tax expense (benefit) from stock issuances	14	(178)
Amortization of deferred financing costs	84	76
Stock-based compensation	3,315	2,225
Change in fair value of contingent consideration	(19)	141
Changes in accounts receivable allowance	186	19
Deferred tax benefit	(965)	(378)
Loss on disposal of fixed assets	1	2
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(874)	(5,092)
Prepaid expense and other current assets	(1,046)	(1,537)
Accounts payable	913	(174)
Deferred revenue	(1,483)	(653)
Debt issuance costs	198	—
Accrued expenses	370	(2,645)
Net cash provided by (used in) operating activities	5,351	(2,712)
Cash flows from investing activities		
Acquisitions, net of cash acquired	(1,862)	—
Restricted cash	61	28
Purchase of furniture, fixtures and equipment	(1,216)	(695)
Net cash used in investing activities	(3,017)	(667)
Cash flows from financing activities		
Proceeds from debt	13,500	—
Principal payments on borrowings	(4,288)	(1,417)
Proceeds from issuance of ESPP shares	295	289
Payment of contingent consideration	(2,483)	(2,322)
Installment payment for acquisition of CCI	—	(661)
Dividend paid	—	(5,189)
Debt issuance costs	9	—
Tax (expense) benefit from stock issuances	(14)	178
Equity securities repurchased	(11,047)	(1,169)
Net cash used in financing activities	(4,028)	(10,291)
Effect of exchange rate changes on cash	(60)	(870)
Net decrease in cash and cash equivalents	(1,754)	(14,540)

Cash and cash equivalents, beginning of period	17,835	27,662
Cash and cash equivalents, end of period	$ 16,081	$ 13,122
Supplemental disclosures of cash flow information:		
Noncash financing activities:		
Issuance of treasury stock for vested restricted stock awards	$ 3,839	$ 3,175

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

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 1—DESCRIPTION OF ORGANIZATION AND BUSINESS OPERATIONS

Information Services Group, Inc. (the "Company") was 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"). The Company is a leading technology insights, market intelligence and advisory services company serving more than 500 clients around the world to help them achieve operational excellence. Based in Stamford, Connecticut, the Company has more than 1,000 employees and operates in 21 countries.

NOTE 2—BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements as of June 30, 2016 and for the three and six months ended June 30, 2016 and 2015, 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 June 30, 2016, the results of operations for the three and six months ended June 30, 2016 and 2015 and the cash flows for the six months ended June 30, 2016 and 2015. The condensed consolidated balance sheet as of December 31, 2015 has been derived from the Company's audited consolidated financial statements. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

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, 2015, which are included in the Company's 2015 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the periods reported. Actual results may differ from those estimates. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the proportional performance method of accounting affect the amounts of revenues, expenses, unbilled receivables and deferred revenue. Numerous internal and external factors can affect estimates. Estimates are also used for but not limited to: allowance for doubtful accounts, useful lives of furniture, fixtures and equipment, depreciation expense, contingent consideration, fair value assumptions in analyzing goodwill and intangible asset impairments, income taxes and deferred tax asset valuation, and the valuation of stock based compensation.

Fair Value

The carrying value of the Company’s cash and cash equivalents, restricted cash, receivables, accounts payable, other current liabilities, and accrued interest approximated their fair values at June 30, 2016 and December 31, 2015 due to the short-term nature of these instruments.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

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 June 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 20	$ —	$ —	$ 20
Total	$ 20	$ —	$ —	$ 20
Liabilities:				
Contingent consideration (1)	$ —	$ —	$ 6,263	$ 6,263
Foreign currency exchange forward contract (2)	—	102	—	102
	$ —	$ 102	$ 6,263	$ 6,365

	Basis of Fair Value Measurements December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 20	$ —	$ —	$ 20
Total	$ 20	$ —	$ —	$ 20
Liabilities:				
Contingent consideration (1)	$ —	$ —	$ 4,019	$ 4,019

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

(2) Included in “Accrued Expenses.”

The Company’s contingent consideration liability was $6.3 million and $4.0 million at June 30, 2016 and December 31, 2015, respectively. 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

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

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 13.5% to 23.5%.

In January 2016, the Company entered into four foreign exchange forward contracts to partially hedge exposure to changes in foreign exchange rates. There are two remaining foreign exchange forward contracts with a EUR notional of 5.0 million and USD notional of 5.5 million at June 30, 2016. These contracts are scheduled to settle at various times throughout 2016. These contracts are marked-to-market with the resulting gains and losses recognized in earnings offsetting the gains and losses on the non-functional currency denominated monetary assets and liabilities being hedged. These derivative contracts are not designated as hedges and are carried at fair value, with changes in the fair value recorded to foreign currency transaction gain (loss) in the condensed consolidated statement of comprehensive income. We recognized a $0.3 million unrealized gain and a $0.1 million of unrealized loss on forward exchange contracts which is reflected on the foreign currency transaction gain (loss) line for the three and six months ended June 30, 2016, respectively. The foreign currency exchange contracts agreement is valued using broker quotations or market transactions in either the listed or over-the-counter markets. These derivative instruments are classified within level 2.

The Company’s financial instruments include outstanding borrowings of $60.0 million at June 30, 2016 and $50.8 million at December 31, 2015, 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 $60.0 million and $50.8 million at June 30, 2016 and December 31, 2015, 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 2.59% to 2.78%. The Company also considered recent transactions of peer group companies for similar instruments with comparable terms and maturities as well as an analysis of current market conditions.

The following table represents the change in the contingent consideration liability during the six months ended June 30, 2016 and 2015:

Six Months
Ended
June 30,

2016 2015