Information Services Group Inc.
Form 10-Q
November 13, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from to

Commission File Number 333-136536

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.)

Four Stamford Plaza
107 Elm 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 x No o

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

Large accelerated filer o Accelerated filer o

Non-accelerated filer x Smaller reporting company o

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

As of October 31, 2008, the registrant had outstanding 31,240,225 shares of common stock, par value $0.001 per share.

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 the Company 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, belie continue, or the negative of such terms or other similar expressions. The actual results of Information Services Group, Inc. (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 furnishes or 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, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 57,015	$ 47,177
Accounts receivable, net of allowance of $87 and $0, respectively	32,279	34,869
Receivables from related parties	39	74
Deferred tax asset	2,474	2,432
Prepaid expense and other current assets	966	2,533
Total current assets	92,773	87,085
Furniture, fixtures and equipment, net of accumulated depreciation of $1,052 and $189, respectively	2,892	2,673
Goodwill	145,079	146,333
Intangible assets, net of accumulated amortization of $7,357 and $722, respectively	111,643	118,278
Other assets	2,540	2,921
Total assets	$ 354,927	$ 357,290
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 2,247	$ 4,760
Current maturities of long-term debt	950	950
Deferred revenue	810	2,128
Accrued expenses	20,515	20,814
Total current liabilities	24,522	28,652
Long-term debt, net of current maturities	93,338	94,050
Deferred tax liability	41,365	43,800
Total liabilities	159,225	166,502
Commitments and contingencies (Note 7)		
Stockholders equity		
Preferred stock, $.001 par value; 10,000 shares authorized; none issued		
Common stock, $.001 par value, 100,000 shares authorized; 31,358 shares issued and 31,366 shares issued and outstanding, respectively	31	31
Additional paid-in-capital	187,773	187,078

Treasury stock (117 shares), net		(580)		
Accumulated other comprehensive loss		(1,470)		(739)
Retained earnings		9,948		4,418
Total stockholders equity		195,702		190,788
Total liabilities and stockholders equity	$	354,927	$	357,290

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

INFORMATION SERVICES GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenue	$ 41,123	$	$ 137,370	$
Operating expenses				
Direct costs and expenses for advisors	22,771		76,827	
Selling, general and administrative	11,934		39,482	
Depreciation and amortization	2,614	2	7,793	7
Formation and operating costs		236		775
Operating income (loss)	3,804	(238)	13,268	(782)
Interest income	307	3,394	963	8,649
Interest expense	(1,572)		(5,162)	(3)
Foreign currency transaction gain (loss)	(3)		405	
Income before taxes	2,536	3,156	9,474	7,864
Income tax provision	1,079	987	3,930	3,034
Net income	1,457	2,169	5,544	4,830
Accretion of trust fund relating to common stock subject to possible conversion		(429)		(432)
Net income attributable to common stockholders	$ 1,457	$ 1,740	$ 5,544	$ 4,398
Weighted average shares outstanding:				
Basic	31,208	40,430	31,290	36,149
Diluted	31,281	40,430	31,357	36,149
Earnings per share:				
Basic	$ 0.05	$ 0.04	$ 0.18	$ 0.12
Diluted	$ 0.05	$ 0.04	$ 0.18	$ 0.12

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, 2008	2007
Cash flows from operating activities		
Net income	$ 5,544	$ 4,830
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	1,157	7
Amortization of intangibles	6,636	
Amortization of deferred financing costs	404	
Compensation costs related to stock-based awards	1,813	
Bad debt expense	87	
Deferred tax benefit	(2,321)	(21)
Loss on disposal of fixed assets	5	
Changes in operating assets and liabilities:		
Accounts receivable	2,123	
Prepaid expense and other assets	1,579	(348)
Accounts payable	(2,513)	(3)
Deferred revenue	(1,318)	
Accrued expenses	1,201	91
Net cash provided by operating activities	14,397	4,556
Cash flows from investing activities		
Purchase of furniture, fixtures and equipment	(1,383)	(2)
Payments of deferred acquisition costs		(583)
Increase in cash and cash equivalents held in trust		(256,420)
Net cash used in investing activities	(1,383)	(257,005)
Cash flows from financing activities		
Payment of notes payable, stockholder		(250)
Principal payments on borrowings	(713)	
Proceeds from issuance of warrants in private placement		6,500
Gross proceeds from public offering		258,750
Payments for underwriters discount and offering cost		(10,604)
Issuance of treasury shares	142	
Equity securities repurchased	(2,255)	
Net cash (used in) provided by financing activities	(2,826)	254,396
Effect of exchange rate changes on cash	(350)	
Net increase in cash and cash equivalents	9,838	1,947
Cash and cash equivalents, beginning of period	47,177	89
Cash and cash equivalents, end of period	$ 57,015	$ 2,036

Supplemental disclosures of cash flow information:				
Cash paid for:				
Interest	$	5,036	$	6
Taxes	$	4,350	$	3,144
Noncash financing and investing activities:				
Accrual of deferred acquisition costs	$		$	625
Deferred underwriters fees	$		$	8,263

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

On November 16, 2007 (the Acquisition Date), ISG consummated the acquisition of TPI Advisory Services Americas, Inc., (the Acquisition) a Texas corporation (TPI), pursuant to a Purchase Agreement (the Purchase Agreement) dated April 24, 2007, as amended on September 30, 2007, by and between MCP-TPI Holdings, LLC, a Texas limited liability company (MCP-TPI), and the Company.

ISG operates as a fact-based sourcing advisory firm specializing in the assessment, evaluation, negotiation and management of service contracts between our clients and those clients service providers. These service contracts typically involve the clients information technology (IT) infrastructure or software applications development, data and voice communications, or business processes such as finance and accounting functions, human resources, call center operations, or supply chain procurement. The majority of ISG s clients are Forbes Global 2000 corporations in the United States, Canada, Western Europe, Asia and Australia. ISG has begun to offer certain products and advisory services to service providers for the purpose of assisting these firms in enhancing the quality of their service offerings. Clients are primarily charged on an hourly basis plus expenses. ISG may also enter into fixed fee arrangements. Advisors and support personnel are based throughout the United States, Canada, Western Europe and Asia-Pacific.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements as of September 30, 2008 and for the three and nine months periods ended September 30, 2008 and 2007, have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and pursuant to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments, (consisting of normal recurring accruals) have been made that are considered necessary for a fair presentation of the financial position as of September 30, 2008, the results of operations for the three and nine months ended September 30, 2008 and 2007, and statements of cash flows for the nine months ended September 30, 2008 and 2007. The condensed consolidated balance sheet as of December 31, 2007 has been derived from the Company s audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 (fiscal 2008).

Certain information and disclosures normally included in the notes to annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted from these interim financial statements when prepared 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, 2007, which are included in the Company s 2007 Form 10-K filed with the Securities and Exchange Commission.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Earnings Per Common Share

Earnings per share is computed in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share*. Basic earnings per share is computed by dividing 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 then shares in the net income of the Company. At September 30, 2008, and for the three and nine months then ended, the effect of 41.0 million warrants, 0.3 million stock appreciation rights and 1.4 million Units (each Unit comprising one common share and one warrant) associated with the Company s IPO underwriters purchase option have not been considered in the diluted earnings per share calculation, since the market price of the Company s common stock was less than the exercise price during the period in the computation. Also, 0.7 million and 1.1 million restricted shares have not been considered in the diluted earnings per share calculation for the three and nine months period ended September 30, 2008, respectively as the effect would be anti-dilutive. At September 30, 2007, and for the three and nine months then ended, the effect of the 38.8 million warrants outstanding has not been considered in the

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

diluted earnings per share since the warrants were contingently exercisable. In addition, the effect of the 1.4 million Units included in the underwriters purchase option, along with the warrants underlying such Units, has not been considered in the diluted earnings per share calculation, since the market price of the Company s common stock was less than the exercise price during the period in the computation.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes methods used to measure fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal periods, as it relates to financial assets and liabilities, as well as for any non-financial assets and liabilities that are carried at fair value. SFAS No. 157 also requires certain tabular disclosures related to the results of applying SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets and SFAS No. 142, Goodwill and Other Intangible Assets. On November 14, 2007, the FASB provided a one year deferral for the implementation of SFAS No. 157 for non-financial assets and liabilities measured at fair value on a non-recurring basis. SFAS No. 157 excludes from its scope SFAS No. 123(R), Share-Based Payment and its related interpretive accounting pronouncements that address share-based payment transactions. The partial adoption of SFAS No. 157 on January 1, 2008 for financial assets and liabilities did not have a material impact on the Company s consolidated financial statements. Based on the November 14, 2007 deferral of SFAS No. 157 for non-financial assets and liabilities, the Company will begin following the guidance of SFAS No. 157 with respect to its non-financial assets and liabilities that are measured at fair value on a non-recurring basis in the quarter ended March 31, 2009. The Company is currently assessing the impact that this pronouncement will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 are effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 in the first quarter of 2008 with no impact on the consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 addresses the accounting and reporting framework for non-controlling interests by a parent company. SFAS No. 160 will be effective for ISG s first quarter of fiscal 2009. The Company does not expect this pronouncement to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R), which replaces SFAS No. 141, *Business Combinations*. SFAS 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including non-controlling interests, contingent consideration, and certain acquired contingencies. SFAS 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS 141R will be applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R would impact the accounting for any businesses acquired by the Company after the effective date of this pronouncement.

NOTE 4 RESTRUCTURING ACCRUAL

Concurrent with the closing of the Acquisition of TPI on November 16, 2007, the Company initiated a Value Creation Plan (VCP) focused on implementing selected cost reductions and productivity improvements to achieve best in class economics and investing in new products and services to accelerate organic growth. Cost reductions and productivity measures center on increasing and/or optimizing the utilization of current billable personnel; implementing a more leveraged staffing and resource model as well as eliminating unnecessary positions, and reducing selected sales, marketing and administrative costs. In addition, compensation and benefit programs will be compared and aligned with industry best practices to ensure competitiveness. The VCP is being implemented during fiscal 2008 and the first half of 2009. The total costs of implementing the VCP are estimated to be between $4.0 million and $6.0 million over the length of the program. A portion of these costs will be applied to the ongoing operating costs of the Company. The balance of the costs (estimated at $6.0 million at December 31, 2007) were accrued as part of the purchase price of the Acquisition in accordance with Emerging Issues Task Force (EITF) 95-3; *Recognition of Liabilities in Connection with a Purchase Business Combination* (or 95-3) During the first nine months of 2008, the Company reduced $1.9 million to the original $6.0 million

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

restructuring accrual in accordance with EITF 95-3, with an offsetting reduction to goodwill, to reflect the latest estimate for remaining restructuring costs applicable to purchase price accounting treatment.

A summary of the activity affecting the Company s accrued restructuring liability for the year ended December 31, 2007 and the first nine months ended September 30, 2008 is as follows:

Balance at December 31, 2007	$	5,825
Adjustments		(1,938)
Amounts paid		(2,480)
Balance at September 30, 2008	$	1,407

Payments to-date have been primarily related to reductions in staffing levels. As of September 30, 2008, we had incurred costs totaling approximately $2.7 million. We expect that the remaining restructuring actions will be completed over the next 3 to 6 months.

NOTE 5 RELATED PARTY TRANSACTIONS

From time to time, the Company also has receivables and payables with employees. All related party transactions have been conducted in the normal course of business. As of September 30, 2008, the Company had outstanding receivables from related parties totaling $0.04 million and no outstanding payables.

NOTE 6 INCOME TAXES

The Company s effective tax rate for the three and nine months ended September 30, 2008 was 42.5% and 41.5% based on a pre-tax profit of $2.5 million and $9.5 million. This compares to 31.3% and 38.6% for the three and nine months ended September 30, 2007, respectively. The Company s effective tax rate for the fiscal year ended December 31, 2007 was 41.9%. This decrease in effective tax rate for the nine months ended September 30, 2008 compared with December 31, 2007 is primarily due to reduced state tax liabilities compared to prior year resulting from the Company s lower U.S. source income subject to state income tax.

As of September 30, 2008, the Company had total unrecognized tax benefits of approximately $0.2 million, of which none of this benefit would impact the Company s effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax provision in its consolidated statement of operations. As of September 30, 2008, the Company s liabilities for interest and penalties were immaterial.

NOTE 7 COMMITMENTS AND CONTINGENCIES

The Company is subject to contingencies which arise through the ordinary course of business. All liabilities of which management is aware are properly reflected in the financial statements at September 30, 2008 and December 31, 2007.

NOTE 8 STOCK-BASED COMPENSATION PLANS

The Company recognized approximately $0.5 and $1.8 million in employee share-based compensation expense during the three and nine months ended September 30, 2008, respectively. Total share-based compensation expense for the nine months ended September 30, 2008 was recognized in general and administrative expenses.

The unrecognized compensation cost related to the Company s unvested stock appreciation rights (SARs) and restricted share grants as of September 30, 2008 was $0.8 million and $5.8 million, respectively, and is expected to be recognized over a weighted-average period of 3.1 years and 2.6 years, respectively.

INFORMATION SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

NOTE 9 COMPREHENSIVE INCOME

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

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net income	$ 1,457	$ 2,169	$ 5,544	$ 4,830
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax of $(975) and $(901), respectively	(1,591)		(731)	
Comprehensive income (loss)	$ (134)	$ 2,169	$ 4,813	$ 4,830

NOTE 10 WARRANTS AND DERIVATIVE INSTRUMENTS

A summary of the warrant activity and changes during the nine months ended September 30, 2008, is presented below.

	Number of Warrants	Weighted-Average Exercise Price
Warrants outstanding as of December 31, 2007	44,972	$ 6.40
Warrants repurchased	(2,574)	$ 6.00
Warrants outstanding as of September 30, 2008	42,398	$ 6.42

NOTE 11 SEGMENT AND GEOGRAPHICAL INFORMATION

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

Geographical information for the segment is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Revenue				
Americas	$ 21,646	$	$ 75,614	$
Europe, Middle East and Africa	16,092		50,765	
Asia Pacific	3,385		10,991	
	$ 41,123	$	$ 137,370	$

	September 30, 2008	December 31, 2007
Identifiable long-lived assets		
Americas	$ 2,535	$ 2,270
Europe, Middle East and Africa	148	178
Asia Pacific	209	225
	$ 2,892	$ 2,673

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

TECHNOLOGY PARTNERS INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands)

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Revenue		