

INNODATA INC  
Form 10-Q  
August 09, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 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: **0-22196**

**INNODATA INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

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

**07601**  
(Zip Code)

**(201) 371-8000**

(Registrant's telephone number, including area code)

[None]

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

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

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

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

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

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

The number of outstanding shares of the registrant's common stock, \$.01 par value, as of July 27, 2016 was 25,445,071.

**INNODATA INC. AND SUBSIDIARIES**

**For the Quarter Ended June 30, 2016**

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Signatures

## INNODATA INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except share and per share amounts)

	June 30, 2016		December 31, 2015
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 24,961		\$ 24,908
Accounts receivable, net	9,702		9,249
Prepaid expenses and other current assets	3,042		2,900
Deferred income taxes	417		282
Total current assets	38,122		37,339
Property and equipment, net	4,756		4,723
Other assets	2,310		2,330
Deferred income taxes	1,333		1,382
Intangibles, net	4,001		3,987
Goodwill	1,531		1,476
Total assets	\$ 52,053		\$ 51,237
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable	\$ 2,047		\$ 1,250
Accrued expenses	3,975		3,312
Accrued salaries, wages and related benefits	5,386		4,905
Income and other taxes	1,236		1,255
Current portion of long term obligations	1,307		1,582
Deferred income taxes	-		76
Total current liabilities	13,951		12,380
Deferred income taxes	722		716
Long term obligations	3,686		3,436
Commitments and contingencies			
Non-controlling interests	(3,451 )		(3,507 )

## STOCKHOLDERS'

## EQUITY:

Serial preferred stock;

5,000,000 shares

authorized, none

outstanding

-

-

Common stock, \$.01 par

value; 75,000,000 shares

authorized; 27,069,000

shares issued and

270

270

25,445,000 outstanding at

June 30, 2016 and

December 31, 2015

Additional paid-in capital

24,852

24,590

Retained earnings

16,149

17,924

Accumulated other

comprehensive income

362

(84

)

(loss)

41,633

42,700

Less: treasury stock,

1,624,000 shares at June 30,

2016 and December 31,

2015, at cost

(4,488

)

(4,488

)

Total stockholders' equity

37,145

38,212

Total liabilities and

stockholders' equity

\$ 52,053

\$ 51,237

See notes to condensed consolidated financial statements.

## INNODATA INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended	
	June 30,	
	2016	2015
Revenues	\$ 15,642	\$ 14,063
Operating costs and expenses:		
Direct operating costs	11,685	10,991
Selling and administrative expenses	5,553	4,278
Interest expense (income), net	16	(19 )
Totals	17,254	15,250
Loss before income taxes	(1,612 )	(1,187 )
Provision for (benefit from) income taxes	258	(254 )
Net loss	(1,870 )	(933 )
Loss attributable to non-controlling interests	92	134
Net loss attributable to Innodata Inc. and Subsidiaries	\$ (1,778 )	\$ (799 )
Loss per share attributable to Innodata Inc. and Subsidiaries:		
Basic and diluted	\$ (0.07 )	\$ (0.03 )
Weighted average shares outstanding:		
Basic and diluted	25,445	25,337
Comprehensive loss:		
Net loss	\$ (1,870 )	\$ (933 )
Pension liability adjustment, net of taxes	(82 )	10
Change in fair value of derivatives, net of taxes	(193 )	(23 )
Foreign currency translation adjustment, net of taxes	8	119
Other Comprehensive income (loss)	(267 )	106
Total Comprehensive loss	(2,137 )	(827 )
Comprehensive loss attributed to non-controlling interest	92	134
Comprehensive loss attributable to Innodata Inc. and Subsidiaries	\$ (2,045 )	\$ (693 )

See notes to condensed consolidated financial statements.

## INNODATA INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited)

(In thousands, except per share amounts)

	Six Months Ended June 30,	
	2016	2015
Revenues	\$31,340	\$27,865
Operating costs and expenses:		
Direct operating costs	23,150	22,115
Selling and administrative expenses	9,364	8,413
Interest expense (income), net	29	(45 )
Totals	32,543	30,483
Loss before income taxes	(1,203 )	(2,618 )
Provision for income taxes	776	301
Net loss	(1,979 )	(2,919 )
Loss attributable to non-controlling interests	204	280
Net loss attributable to Innodata Inc. and Subsidiaries	\$(1,775 )	\$(2,639 )
Loss per share attributable to Innodata Inc. and Subsidiaries:		
Basic and diluted	\$(0.07 )	\$(0.10 )
Weighted average shares outstanding:		
Basic and diluted	25,445	25,337
Comprehensive loss:		
Net loss	\$(1,979 )	\$(2,919 )
Pension liability adjustment, net of taxes	(164 )	20
Change in fair value of derivatives, net of taxes	246	483
Foreign currency translation adjustment, net of taxes	364	(420 )
Other Comprehensive income	446	83
Total Comprehensive loss	(1,533 )	(2,836 )
Comprehensive loss attributed to non-controlling interest	204	280
Comprehensive loss attributable to Innodata Inc. and Subsidiaries	\$(1,329 )	\$(2,556 )

See notes to condensed consolidated financial statements.

## INNODATA INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)  
(In thousands)

	Six Months Ended June 30,	
	2016	2015
Cash flow from operating activities:		
Net loss	\$(1,979 )	\$(2,919 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	1,324	1,436
Stock-based compensation	522	559
Deferred income taxes	(232 )	(211 )
Pension cost	82	316
Changes in operating assets and liabilities:		
Accounts receivable	(188 )	615
Prepaid expenses and other current assets	17	74
Other assets	(139 )	(111 )
Accounts payable and accrued expenses	1,356	196
Accrued salaries, wages and related benefits	479	544
Income and other taxes	(73 )	(7 )
Net cash provided by operating activities	1,169	492
Cash flow from investing activities:		
Capital expenditures	(871 )	(298 )
Net cash used in investing activities	(871 )	(298 )
Cash flow from financing activities:		
Payment of long term obligations	(340 )	(583 )
Net cash used in financing activities	(340 )	(583 )
Effect of exchange rate changes on cash and cash equivalents	95	(131 )
Net increase (decrease) in cash and cash equivalents	53	(520 )
Cash and cash equivalents, beginning of period	24,908	24,216
Cash and cash equivalents, end of period	\$24,961	\$23,696
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$688	\$412

See notes to condensed consolidated financial statements.

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## INNODATA INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

## SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(Unaudited)

(In thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
	Shares	Amount					
January 1, 2016	25,445	\$ 270	\$ 24,590	\$ 17,924	\$ (84 )	\$(4,488 )	\$38,212
Net loss	-	-	-	(1,775 )	-	-	(1,775 )
Stock-based compensation	-	-	522	-	-	-	522
Acquisition of non-controlling interest	-	-	(260 )	-	-	-	(260 )
Pension liability adjustments, net of taxes	-	-	-	-	(164 )	-	(164 )
Foreign currency translation adjustment, net of taxes	-	-	-	-	364	-	364
Change in fair value of derivatives, net of taxes	-	-	-	-	246	-	246
June 30, 2016	25,445	\$ 270	\$ 24,852	\$ 16,149	\$ 362	\$(4,488 )	\$37,145
January 1, 2015	25,337	\$ 268	\$ 22,780	\$ 20,750	\$ (287 )	\$(4,288 )	\$39,223
Net loss	-	-	-	(2,639 )	-	-	(2,639 )
Stock-based compensation	-	-	559	-	-	-	559
Pension liability adjustments, net of taxes	-	-	-	-	20	-	20
Foreign currency translation adjustment, net of taxes	-	-	-	-	483	-	483
Change in fair value of derivatives, net of taxes	-	-	-	-	(420 )	-	(420 )
June 30, 2015	25,337	\$ 268	\$ 23,339	\$ 18,111	\$ (204 )	\$(4,288 )	\$37,226

See notes to condensed consolidated financial statements.

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

**1. Description of Business and Summary of Significant Accounting Policies**

**Description of Business-** Innodata Inc. (the “Company”) is a global digital services and solutions company. The Company’s technology and services power leading information products and online retail destinations around the world. The Company’s solutions help prestigious enterprises harness the power of digital data to re-imagine how they operate and drive performance. The Company serves publishers, media and information companies, digital retailers, banks, insurance companies, government agencies and many other industries.

The Company operates in three reporting segments: Digital Data Solutions (DDS), Innodata Advanced Data Solutions (IADS) and Media Intelligence Solutions (MIS). DDS was formerly known as Content Services.

The Company’s DDS segment provides solutions to digital retailers, information services companies, publishers and enterprises that have one or more of the following broad business requirements: development of digital content (including e-books); development of new digital information products; and operational support of existing digital information products and systems.

The Company’s IADS segment designs and develops new capabilities to enable clients in the financial services, insurance, medical and healthcare sectors to improve decision-support through digital technologies. IADS operates through two subsidiaries: Synodex offers a range of services for healthcare, medical and insurance companies, and docGenix provides services to financial services institutions. As of June 30, 2016 Innodata owned 91% of Synodex and 94% of docGenix, both limited liability companies.

In July 2014, the Company acquired MediaMiser, a leading provider of media monitoring and analysis software and professional services for organizations of all sizes. Through its innovative web-based and mobile solutions, MediaMiser reduces the time and effort it takes to gather, analyze and distribute valuable business intelligence extracted from traditional and social media sources. For organizations that prefer to outsource, MediaMiser also provides detailed analysis reports and daily media briefings through an expert client services team. In December 2014, the Company acquired intellectual property and related assets of Bulldog Reporter. Bulldog Reporter has provided PR industry newsletters, a journalist database, media intelligence and professional development programs for over 30 years. The Company’s MIS segment operates through its MediaMiser and Bulldog Reporter subsidiaries.

**Basis of Presentation**-The condensed consolidated financial statements for the interim periods included herein are unaudited; however, they contain all adjustments (consisting of only normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company as of June 30, 2016, the results of its operations and comprehensive loss for the three and six months ended June 30, 2016 and 2015, and cash flows and stockholders' equity for the six months ended June 30, 2016 and 2015. The results of operations for the interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2015, included in the Company's Annual Report on Form 10-K. Unless otherwise noted, the accounting policies used in preparing these condensed consolidated financial statements are the same as those described in the December 31, 2015 consolidated financial statements.

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

**Principles of Consolidation**-The consolidated financial statements include the accounts of Innodata Inc. and its wholly-owned subsidiaries, MediaMiser, a corporation in which the Company owns substantially all of the economic interest, and the Synodex and docGenix limited liability companies that are majority-owned by the Company. The non-controlling interests in the Synodex and docGenix limited liability companies are accounted for in accordance with Financial Accounting Standards Board (FASB) non-controlling interest guidance. All significant intercompany transactions and balances have been eliminated in consolidation.

**Use of Estimates**-In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include those related to revenue recognition, allowance for doubtful accounts and billing adjustments, long-lived assets, intangible assets, goodwill, valuation of deferred tax assets, valuation of securities underlying stock-based compensation, litigation accruals, pension benefits, purchase price allocation of the assets acquired in the acquisition of MediaMiser and Bulldog Reporter, valuation of derivative instruments and estimated accruals for various tax exposures.

**Foreign Currency Translation**-The functional currency for the Company's production operations located in the Philippines, India, Sri Lanka and Israel is the U.S. dollar. Transactions denominated in Philippine pesos, Indian and Sri Lankan rupees and Israeli shekels are translated to U.S. dollars at rates which approximate those in effect on transaction dates.

The functional currency of the foreign subsidiaries located in Germany and Canada are the Euro and the Canadian dollar, respectively. The financial statements of these subsidiaries are reported in these respective currencies. Financial information is translated from the applicable functional currency to the U.S. dollar (the reporting currency) for inclusion in our condensed consolidated financial statements. Income, expenses and cash flows are translated at weighted average exchange rates prevailing during the fiscal period, and assets and liabilities are translated at fiscal period-end exchange rates. Resulting translation adjustments are included as a component of accumulated other comprehensive loss in stockholders' equity. Foreign exchange transaction gains or losses are included in direct operating costs in the accompanying condensed consolidated statements of operations and comprehensive loss.

**Revenue Recognition**-For the DDS segment, revenue is recognized based on the quantity delivered or resources utilized, the period in which services are performed and delivered. Revenues for contracts billed on a

time-and-materials basis are recognized as services are performed. Revenues under fixed-fee contracts, which are not significant to the overall revenues, are recognized on the percentage of completion method of accounting, as services are performed or milestones are achieved.

For the IADS segment, revenue is recognized primarily based on the quantity delivered and the period in which services are performed and deliverables are made as per contracts. A portion of our IADS segment revenue is derived from licensing our software and providing access to our hosted software platform. Revenue from such services are recognized monthly when access to the service is provided to the end user and there are no significant remaining obligations, persuasive evidence of an arrangement exists, the fees are fixed or determinable and collection is reasonably assured.

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

The MIS segment derives its revenues primarily from subscription arrangements and provision of enriched media analysis services. Revenue from subscriptions is recognized monthly when access to the service is provided to the end user and there are no significant remaining obligations, persuasive evidence of an arrangement exists, the fees are fixed or determinable and collection is reasonably assured. Revenues from enriched media analysis services are recognized when the services are performed and delivered to the clients.

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

**Recent Accounting Pronouncements**-In May 2014, the FASB issued guidance on revenue from contracts with customers. This update is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This accounting guidance is effective prospectively for annual reporting periods, and interim periods within those periods, beginning after December 15, 2017 and early adoption is permitted in the first quarter of 2017. Companies may use either a full retrospective or a modified retrospective approach to adopt the new standard when it takes effect. The Company has not yet determined the potential effects of the adoption of this standard on its condensed consolidated financial statements.

In November 2015, the FASB issued guidance related to balance sheet classification of deferred taxes. This new guidance requires that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company does not anticipate that adoption of this standard will have a material impact on its condensed consolidated financial statements.

In February 2016, the FASB issued guidance related to leases. This new guidance requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. This new guidance is effective for annual periods beginning after

December 15, 2018. Early application is permitted. The Company has not yet determined the potential effects of the adoption of this standard on its condensed consolidated financial statements.

In March 2016, the FASB issued guidance relating to share based compensation. This new guidance is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new guidance is effective for annual periods beginning after December 15, 2016. Early application is permitted. The Company does not anticipate that adoption of this standard will have a material impact on its condensed consolidated financial statements.

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

**2. Property and Equipment**

Property and equipment are stated at costs less accumulated depreciation and amortization (in thousands), and consist of the following:

	June 30, 2016	December 31, 2015
Equipment	\$13,725	\$ 13,437
Software	5,311	5,089
Furniture and equipment	2,120	2,313
Leasehold improvements	4,907	4,956
Total	26,063	25,795
Less: accumulated depreciation and amortization	(21,307)	(21,072 )
	\$4,756	\$ 4,723

Depreciation and amortization expense of property and equipment was approximately \$0.5 million for the three months ended June 30, 2016 and 2015, respectively. Depreciation and amortization expense of property and equipment was approximately \$0.9 million and \$1.0 million for the six months ended June 30, 2016 and 2015, respectively.

**3. Goodwill and Intangible Assets**

The changes in the carrying amount of goodwill for the six months ended June 30, 2016 and June 30, 2015 were as follows (in thousands):

Balance as of January 1, 2016	\$1,476
Foreign currency translation adjustment	55
Balance as of June 30, 2016	\$1,531
Balance as of January 1, 2015	\$1,635
Foreign currency translation adjustment	(62 )
Balance as of June 30, 2015	\$1,573

Information regarding the Company's acquisition-related intangible assets is as follows (in thousands):

	Developed technology	Customer relationships	Trademarks and tradenames	Patents	Total
Gross carrying amounts:					
Balance as of January 1, 2016	\$ 1,978	\$ 2,036	\$ 555	\$ 41	\$4,610
Foreign currency translation	137	141	17	3	298
Balance as of June 30, 2016	\$ 2,115	\$ 2,177	\$ 572	\$ 44	\$4,908

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

	Developed technology	Customer relationships	Trademarks and tradenames	Patents	Total
Gross carrying amounts:					
Balance as of January 1, 2015	\$ 2,369	\$ 2,439	\$ 596	\$ 50	\$5,454
Foreign currency translation	(151 )	(157 )	(13 )	(4 )	(325 )
Balance as of June 30, 2015	\$ 2,218	\$ 2,282	\$ 583	\$ 46	\$5,129

	Developed technology	Customer relationships	Trademarks and tradenames	Patents	Total
Accumulated amortization:					
Balance as of January 1, 2015	\$ 98	\$ 84	\$ 11	\$ -	\$193
Amortization expense	113	97	46	4	260
Foreign currency translation	(8 )	(7 )	(1 )	-	(16 )
Balance as of June 30, 2015	\$ 203	\$ 174	\$ 56	\$ 4	\$437

Amortization expense relating to acquisition-related intangible assets was \$0.1 million and \$0.2 million for the three months ended June 30, 2016 and 2015, respectively.

Amortization expense relating to acquisition-related intangible assets was \$0.2 million and \$0.3 million for the six months ended June 30, 2016 and 2015, respectively.

Estimated amortization expense for intangible assets subsequent to June 30, 2016 is as follows (in thousands):

Year	Amortization
2016	\$ 244
2017	487
2018	487
2019	454
2020	422
Thereafter	1,907
	\$ 4,001



**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

**4. Income Taxes**

The Company had unrecognized tax benefits of approximately \$1.2 million as of June 30, 2016 and December 31, 2015, respectively. The portion of unrecognized tax benefits relating to interest and penalties was approximately \$0.5 million at June 30, 2016 and December 31, 2015, respectively. The unrecognized tax benefits as of June 30, 2016 and December 31, 2015, if recognized, would have an impact on the Company's effective tax rate.

The following presents a roll-forward of the Company's unrecognized tax benefits and associated interest for the six months ended June 30, 2016 (amounts in thousands):

	Unrecognized tax benefits
Balance - January 1, 2016	\$ 1,207
Decrease for tax position settled for prior years	(108 )
Increase for tax provision	40
Interest accrual	32
Foreign currency revaluation	(14 )
Balance - June 30, 2016	\$ 1,157

The Company is subject to Federal income tax, as well as income tax in various states and foreign jurisdictions. The Company is no longer subject to examination by Federal tax authorities for years prior to 2006 and by New Jersey tax authorities for years prior to 2012. Various foreign subsidiaries currently have open tax years from 2003 through 2015.

Pursuant to an income tax audit by the Indian Bureau of Taxation in 2009, the Company's Indian subsidiaries received a tax assessment approximating \$303,000 including interest, through June 30, 2016 for the fiscal year ended March 31, 2006. Management disagrees with the basis of these tax assessments, has filed an appeal against the assessments and is contesting them vigorously. In January 2012, the Indian subsidiary received a final tax assessment of approximately \$1.0 million, including interest, for the fiscal year ended March 31, 2008, from the Indian Bureau of Taxation. Management disagrees with the basis of this tax assessment, and has filed an appeal against it. Due to this assessment, the Company recorded a tax provision amounting to \$482,000 including interest through June 30, 2016. In April 2015, the Company received a favorable judgment whereby the Appeal Officer reduced the tax assessment to \$0.3 million. Under the Indian Income Tax Act, however, the income tax assessing officer has the right to appeal

against the judgment passed by the Appeal Officer. In the third quarter of 2015, the income tax assessing officer exercised this right and filed an appeal. Based on recent experience, management believes that the tax provision of \$482,000 including interest is adequate. As the Company is continually subject to tax audits by the Indian Bureau of Taxation, the Company continuously assesses the likelihood of an unfavorable assessment for all fiscal years for which the Company has not been audited and, as of June 30, 2016, the Company recorded a tax provision amounting to \$155,000 including interest for such year.

In 2015 the Company's Indian subsidiary was subject to an inquiry by the Service Tax Bureau in India regarding the classification of services provided by this subsidiary, asserting that the services provided by this subsidiary fall under the category of online information and database access or retrieval services (OID Services), and not under the category of business support services (BS Services) that are exempt from service tax as historically indicated in the subsidiary's service tax filings. In the event the Service Tax Bureau is successful in proving that the services fall under the category of OID Services the revenues earned by the Company's Indian subsidiary would be subject to a service tax of approximately 14.5% of revenues and this would increase the operating costs of the Company by an equivalent amount. The revenues of the Company's Indian subsidiary for the six months ended June 30, 2016 were \$8.5 million. The Company disagrees with the Service Tax Bureau's position and is contesting these assertions vigorously.

**INNODATA INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(Unaudited)**

In 2016 the Company's Indian subsidiary received notices of appeal from the Commissioner, Service Tax, seeking to reverse service tax refunds previously granted to our Indian subsidiary for certain quarters in 2014 and 2015, asserting that the services provided by this subsidiary fall under the category of OID Services and not BS Services. The Company disagrees with the basis of these appeals and is contesting them vigorously. The Company expects delays in receiving service tax refunds until such time as the appeals are adjudicated with finality.

From time to time the Company is also subject to various other tax proceedings and claims for its India and Philippines subsidiaries. The Company has recorded a tax provision amounting to \$217,000 including interest through June 30, 2016, for several other ongoing tax proceedings in India and the Philippines. Although the ultimate outcome cannot be determined at this time, the Company continues to contest these claims vigorously.

The Company projects that during the period from 2016 through 2018 the U.S. entity may not have sufficient cash to pay in full amounts that will be payable by it to the Company's Asian operating subsidiaries and that the cash deficit will amount to approximately \$6.0 million. The resulting deferral in payments would result in a deemed dividend that would be taxable income to the U.S. entity and would be set off against its net operating loss carryforwards. The Company adjusted its deferred tax assets and the corresponding valuation allowance as of June 30, 2016 to reflect the projected deferral. In the second quarter of 2016 the U.S. entity deferred \$2.3 million in payments due to its Asian operating subsidiaries.

## **5. Commitments and Contingencies**

**Litigation** - In 2008, the Supreme Court of the Republic of the Philippines refused to review a decision of the Court of Appeals in Manila against a Philippines subsidiary of the Company that is inactive and has no material assets, and purportedly also against Innodata Inc., that orders the reinstatement of certain former employees of the subsidiary to their former positions and also orders the payment of back wages and benefits that aggregate approximately \$8.0 million. Based on consultation with legal counsel, the Company believes that recovery against the Company is unlikely.

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

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

The Company's legal reserves related to legal proceedings and claims are based on a determination of whether or not a loss is probable. The Company reviews outstanding proceedings and claims with external counsel to assess probability and estimates of loss. The reserves are adjusted if necessary. While the Company intends to defend these matters vigorously, adverse outcomes that it estimates could reach approximately \$100,000 in the aggregate beyond recorded amounts are reasonably possible. If circumstances change, the Company may be required to record adjustments that could be material to its reported consolidated financial condition and results of operations.

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**Foreign Currency**-To the extent that the currencies of the Company's production facilities located in the Philippines, India, Sri Lanka and Israel fluctuate, the Company is subject to risks of changing costs of production after pricing is established for certain client projects. In addition, the Company is exposed to the risk of foreign currency fluctuation on the non-U.S. dollar denominated revenues, and on the monetary assets and liabilities held by its foreign subsidiaries that are denominated in local currency.

**Indemnifications**-The Company is obligated under certain circumstances to indemnify directors, certain officers and employees against costs and liabilities incurred in actions or threatened actions brought against such individuals because such individuals acted in the capacity of director and/or officer or fiduciary of the Company. In addition, the Company has contracts with certain clients pursuant to whom the Company has agreed to indemnify the client for certain specified and limited claims. These indemnification obligations occur in the ordinary course of business and, in many cases, do not include a limit on potential maximum future payments. As of June 30, 2016, the Company has not recorded a liability for any obligations arising as a result of these indemnifications.

**Liens**-In connection with the procurement of tax incentives at one of the Company's foreign subsidiaries, the foreign zoning authority was granted a first lien on the subsidiary's property and equipment. As of June 30, 2016, the net book value of the property and equipment was \$0.4 million.

## **6. Stock Options**

On June 7, 2016 stockholders of the Company approved amendments to the Innodata Inc. 2013 Stock Plan. The Innodata Inc. 2013 Stock Plan as amended and restated effective June 7, 2016 is referred to herein as the "Plan." The number of shares of common stock of Innodata Inc. ("Stock") that may be delivered, purchased or used for reference purposes (with respect to stock appreciation rights or stock units) for awards granted under the Plan after June 7, 2016 is 5,858,892 (the "Share Reserve"). Shares subject to an option or stock appreciation right granted under the Plan after June 7, 2016 shall count against the Share Reserve as one share for every share granted, and shares subject to any other type of award granted under the Plan after June 7, 2016 shall count against the Share Reserve as two shares for every share granted. Any award, or portion of an award, under the Plan or under the 2009 Stock Plan (as amended and restated (the "Prior Plan")) that expires or terminates unexercised, becomes unexercisable or is forfeited or otherwise terminated, surrendered or canceled as to any shares without delivery of shares or other consideration shall be added back to the Share Reserve as one share for each such share that was subject to an option or stock appreciation right granted under the Plan or the Prior Plan, and two shares for each such share that was subject to an award other than an option or stock appreciation right granted under the Plan or the Prior Plan. If any shares are withheld, tendered or exchanged by a participant in the Plan as full or partial payment to Innodata of the exercise price under an option

under the Plan or the Prior Plan or in satisfaction of a participant's tax withholding obligations with respect to any award under the Plan or the Prior Plan, there shall be added back to the Share Reserve one share for each such share that was withheld, tendered or exchanged in respect of an option or stock appreciation right granted under the Plan or the Prior Plan, and two shares for each such share that was withheld, tendered or exchanged in respect of an award other than an option or stock appreciation right granted under the Plan or the Prior Plan.

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

	Number of Options	Weighted - Average Exercise Price	Weighted- Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2016	3,970,146	\$ 3.02		
Granted	710,000	2.67		
Exercised	-	-		
Forfeited/Expired	(124,033 )	3.19		
Outstanding at June 30, 2016	4,556,113	\$ 2.96	5.56	\$ 28,800
Exercisable at June 30, 2016	2,343,062	\$ 3.14	4.04	\$ 2,376
Vested and Expected to Vest at June 30, 2016	4,556,113	\$ 2.96	5.56	\$ 28,800

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

	Six Months Ended June 30,	
	2016	2015
Weighted average fair value of options granted	\$ 1.09	\$ -
Risk-free interest rate	1.38% - 1.73%	-
Expected life (years)	5-6	-
Expected volatility factor	49	% -
Expected dividends	-	-

The total compensation cost related to non-vested stock awards not yet recognized as of June 30, 2016 totaled approximately \$1.7 million. The weighted-average period over which these costs will be recognized is twenty six months.

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

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	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Direct operating costs	\$ 74	\$ 104	\$ 164	\$ 195
Selling and administrative expenses	169	170	358	364
Total stock-based compensation	\$ 243	\$ 274	\$ 522	\$ 559

There were no options exercised in the six months ended June 30, 2016.

**7. Long term obligations**

Total long-term obligations as of June 30, 2016 and December 31, 2015 consist of the following (in thousands):

	June 30,	December 31,
	2016	2015
Vendor obligations		
Capital lease obligations <sup>(1)</sup>	\$ 372	\$ 423
Deferred lease payments <sup>(2)</sup>	708	707
Microsoft licenses <sup>(3)</sup>	170	360
Acquisition related liability <sup>(4)</sup>	1,062	993
Pension obligations		
Accrued pension liability	2,681	2,535
	4,993	5,018
Less: Current portion of long term obligations	1,307	1,582
Totals	\$ 3,686	\$ 3,436

<sup>(1)</sup> In March 2014, the Company entered into an equipment sale leaseback agreement with a financing company. The cash proceeds from the transaction were \$0.9 million. The Company leased the equipment for a period of 36 months at an effective interest rate of approximately 6% and has the option to purchase the equipment for a nominal amount at the end of the lease term. The Company has accounted for this transaction as a financing arrangement, wherein the equipment remains on the Company's books and will continue to be depreciated. As of June 30, 2016, the Company had made \$0.8 million in lease payments under the sale leaseback agreement.

(2) Deferred lease payments represent the effect of straight-lining operating lease payments over the respective lease terms.

(3) In March 2014, the Company renewed a vendor agreement to acquire certain additional software licenses and to receive support and subsequent software upgrades on these and other currently owned software licenses through February 2017. Pursuant to this agreement, the Company is obligated to pay approximately \$0.4 million annually over the term of the agreement. The total cost, net of deferred interest (in thousands), was allocated to the following asset accounts in 2014:

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Prepaid expenses and other current assets	\$ 356
Other assets	713
Property and equipment	136
	\$ 1,205

<sup>(4)</sup> Amount represents a portion of the purchase price consideration for the acquisition of MediaMiser as follows: \$0.6 million paid by the Company on July 28, 2016 in shares of Innodata Inc.'s common stock. In addition, the Company agreed to pay up to a maximum of \$4.6 million of contingent consideration based on MediaMiser's achieving certain revenue and EBITDA levels during the period from April 1, 2016 to March 31, 2017. The fair value of the contingent consideration as of June 30, 2016 was \$0.5 million.

**8. Comprehensive Income (Loss)**

Accumulated other comprehensive loss, as reflected in the condensed consolidated balance sheets, consists of pension liability adjustments, net of taxes, foreign currency translation adjustment, net of taxes and changes in fair value of derivatives, net of taxes. The components of accumulated other comprehensive loss as of June 30, 2016, and reclassifications out of accumulated other comprehensive income (loss) for the six months ended June 30, 2016 and 2015, were as follows (net of tax):

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	Pension Liability Adjustment	Fair Value of Derivatives	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss)
Balance at April 1, 2016	\$ 1,441	\$ 274	\$ (1,086)	) \$ 629
Other comprehensive income (loss) before reclassifications, net of taxes	-	(152 )	8	(144 )
Total other comprehensive income (loss) before reclassifications, net of taxes	1,441	122	(1,078)	) 485
Net amount reclassified to earnings	(82 )	(41 )	-	(123 )
Balance at June 30, 2016	\$ 1,359	\$ 81	\$ (1,078)	) \$ 362

	Pension Liability Adjustment	Fair Value of Derivatives	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss)
Balance at April 1, 2015	\$ 507	\$ 169	\$ (986)	) \$ (310 )
Other comprehensive income (loss) before reclassifications, net of taxes	-	(69 )	119	50
Total other comprehensive income (loss) before reclassifications, net of taxes	507	100	(867)	) (260 )
Net amount reclassified to earnings	10	46		56
Balance at June 30, 2015	\$ 517	\$ 146	\$ (867)	) \$ (204 )

	Pension Liability Adjustment	Fair Value of Derivatives	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2016	\$ 1,523	\$ (165 )	\$ (1,442)	) \$ (84 )
Other comprehensive income before reclassifications, net of taxes	-	234	364	598
Total other comprehensive income (loss) before reclassifications, net of taxes	1,523	69	(1,078)	) 514
Net amount reclassified to earnings	(164 )	12	-	(152 )
Balance at June 30, 2016	\$ 1,359	\$ 81	\$ (1,078)	) \$ 362

	Pension Liability Adjustment	Fair Value of Derivatives	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2015	\$ 497	\$ (337 )	\$ (447)	) \$ (287 )

Other comprehensive income (loss) before reclassifications, net of taxes	-	405	(420)	)	(15)	)
Total other comprehensive income (loss) before reclassifications, net of taxes	497	68	(867)	)	(302)	)
Net amount reclassified to earnings	20	78	-		98	
Balance at June 30, 2015	\$ 517	\$ 146	\$ (867)	)	\$ (204)	)

All reclassifications out of accumulated other comprehensive income (loss) had an impact on direct operating costs in the condensed consolidated statements of operations and comprehensive loss.

## 9. Segment Reporting and Concentrations

The Company's operations are classified into three reportable segments: Digital Data Solutions (DDS), Innodata Advanced Data Solutions (IADS) and Media Intelligence Solutions (MIS).

The DDS segment provides solutions to digital retailers, information services companies, publishers and enterprises that have one or more of the following broad business requirements: development of digital content (including e-books); development of new digital information products; and operational support of existing digital information products and systems.

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The IADS segment performs advanced data analysis. IADS operates through two subsidiaries: Synodex and docGenix. Synodex offers a range of data analysis services in the healthcare, medical and insurance areas. docGenix provides services to certain financial services institutions.

In July 2014, the Company acquired MediaMiser, an Ottawa, Canada-based provider of automated, real-time traditional and social media monitoring services. In December 2014, the Company acquired intellectual property and related assets of Bulldog Reporter. Both these businesses constitute the Company's MIS segment.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues:				
DDS	\$ 13,232	\$ 12,370	\$ 26,876	\$ 24,561
IADS	1,165	545	2,062	950
MediaMiser	1,245	1,148	2,402	2,354
Total Consolidated	\$ 15,642	\$ 14,063	\$ 31,340	\$ 27,865
Loss before provision for income taxes <sup>(1)</sup> :				
DDS	\$ 81	\$ 701	\$ 2,327	\$ 1,064
IADS	(1,089 )	(1,500 )	(2,458 )	(3,095 )
MediaMiser	(604 )	(388 )	(1,072 )	(587 )
Total Consolidated	\$ (1,612 )	\$ (1,187 )	\$ (1,203 )	\$ (2,618 )
Loss before provision for income taxes <sup>(2)</sup> :				
DDS	\$ (640 )	\$ 98	\$ 902	\$ (120 )
IADS	(374 )	(898 )	(1,045 )	(1,912 )
MediaMiser	(598 )	(387 )	(1,060 )	(586 )
Total Consolidated	\$ (1,612 )	\$ (1,187 )	\$ (1,203 )	\$ (2,618 )

	June 30, 2016	December 31, 2015
Total assets:		
DDS	\$ 41,513	\$ 41,842
IADS	1,242	1,026
MediaMiser	9,298	8,369
Total Consolidated	\$ 52,053	\$ 51,237

(1) Before elimination of any inter-segment profits

(2) After elimination of any inter-segment profits

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

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	Three months ended		Six months ended	
	June 30, 2016	2015	June 30, 2016	2015
United States	\$ 8,079	\$ 6,615	\$ 16,351	\$ 13,203
The Netherlands	2,529	2,648	5,090	4,760
United Kingdom	1,999	2,050	3,980	4,251
Canada	1,498	1,456	2,974	2,827
Other - principally Europe	1,537	1,294	2,945	2,824
	\$ 15,642	\$ 14,063	\$ 31,340	\$ 27,865

Long-lived assets as of June 30, 2016 and December 31, 2015, respectively, by geographic region, are comprised of (in thousands):

	June 30, 2016	December 31, 2015
United States	\$ 1,292	\$ 1,104
Foreign countries:		
Philippines	1,537	5,223
India	1,657	1,611
Sri Lanka	518	1,580
Canada	5,252	635
Israel	30	31
Germany	2	2
Total foreign	8,996	9,082
	\$ 10,288	\$ 10,186

Two clients in the DDS Segment generated approximately 33% of the Company's total revenues for the three months ended June 30, 2016 and 36% of the Company's total revenues for the three months ended June 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the three months ended June 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 53%, respectively, of the Company's total revenues.

Two clients in the DDS Segment generated approximately 32% of the Company's total revenues for the six months ended June 30, 2016 and 35% of the Company's total revenues for the six months ended June 30, 2015. Another client in the DDS segment accounted for 10% of the Company's total revenues for the six months ended June 30, 2016 but accounted for less than 10% of the Company's total revenues for the six months ended June 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the six months ended June 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 53%, respectively, of the Company's total revenues.

As of June 30, 2016, approximately 57% of the Company's accounts receivable was from foreign (principally European) clients and 59% of accounts receivable was due from four clients. As of December 31, 2015, approximately 62% of the Company's accounts receivable was from foreign (principally European) clients and 68% of accounts receivable was due from four clients.

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**10. Loss Per Share**

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Net loss attributable to Innodata Inc. and Subsidiaries	\$ (1,778 )	\$ (799 )	\$ (1,775 )	\$ (2,639 )
Weighted average common shares outstanding	25,445	25,337	25,445	25,337
Dilutive effect of outstanding options	-	-	-	-
Adjusted for dilutive computation	25,445	25,337	25,445	25,337

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

Options to purchase 4.6 million shares and 2.6 million shares of common stock for the three months ended June 30, 2016 and 2015, respectively, were outstanding but not included in the computation of diluted net loss per share, because the options exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive. In addition, diluted net loss per share for the three months ended June 30, 2015 does not include 1.0 million potential shares of common stock derived from the exercise of stock options, because as a result of the Company’s incurring losses, their effect would have been anti-dilutive.

Options to purchase 4.3 million shares and 2.6 million shares of common stock for the six months ended June 30, 2016 and 2015, respectively, were outstanding but not included in the computation of diluted net loss per share, because the options exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive. In addition, diluted net loss per share for the six months ended June 30, 2016 and 2015 does not include 0.3 million and 1.0 million potential shares of common stock, respectively, derived from the exercise of stock options, because as a result of the Company’s incurring losses, their effect would have been anti-dilutive.

**11. Derivatives**

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

In addition, although the majority of the Company's revenues is denominated in U.S. dollars, a significant portion of the total revenues is denominated in Canadian dollars and Euros.

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

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The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company does not hold or issue derivatives for trading purposes. All derivatives are recognized at their fair value and classified based on the instrument's maturity date. The total notional amount for outstanding derivatives as of June 30, 2016 and December 31, 2015 was \$18.6 million and \$15.8 million, respectively, which is comprised of cash flow hedges denominated in U.S. dollars.

The following table presents the fair value of derivative instruments included within the consolidated balance sheets as of June 30, 2016 and December 31, 2015 (in thousands):

	Balance Sheet Location	Fair Value	
		2016	2015
Derivatives designated as hedging instruments:			
Foreign currency forward contracts	Prepaid expenses and other current assets	\$81	\$-
Foreign currency forward contracts	Accrued expenses	\$-	\$165

The effects of foreign currency forward contracts designated as cash flow hedges on the Company's condensed consolidated statements of operations and comprehensive loss for the three and six months ended June 30, 2016 and 2015, respectively, were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2016	2015	2016	2015
Net gain (loss) recognized in OCI <sup>(1)</sup>	\$ (152 )	\$ (69 )	\$ 234	\$ 405
Net gain (loss) reclassified from accumulated OCI into income <sup>(2)</sup>	\$ 41	\$ (46 )	\$ (12 )	\$ (78 )
Net gain recognized in income <sup>(3)</sup>	\$ -	\$ -	\$ -	\$ -

<sup>(1)</sup>Net change in fair value of the effective portion classified into other comprehensive income ("OCI").

<sup>(2)</sup>Effective portion classified within direct operating cost.

<sup>(3)</sup>There were no effective portions for the period presented.

## 12. Financial Instruments

The carrying amounts of financial instruments, including cash and cash equivalents, accounts receivable and accounts payable approximated their fair value as of June 30, 2016 and December 31, 2015, because of the relative short maturity of these instruments.

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

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

·*Level 1*: Unadjusted quoted price in active market for identical assets and liabilities.

·*Level 2*: Observable inputs other than those included in Level 1.

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

The following table sets forth the assets and liabilities as of June 30, 2016 and December 31, 2015 that the Company measured at fair value, on a recurring basis by level, within the fair value hierarchy (in thousands). As required by the standard, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

June 30, 2016	Level 1	Level 2	Level 3
Assets			
Derivatives	\$ -	\$ 81	\$ -
Liabilities			
Contingent Considerations	\$ -	\$ -	\$ 477
December 31, 2015			
	Level 1	Level 2	Level 3
Liabilities			
Derivatives	\$ -	\$ 165	\$ -
Contingent Considerations	\$ -	\$ -	\$ 453

The following table summarizes the change in fair value of the Level 3 liability for the six months ended June 30, 2016:

Balance at January 1, 2016	\$453
Effect of foreign currency translation adjustment	24
Balance at June 30, 2016	\$477

The Level 2 liabilities contain foreign currency forward contracts. Fair value is determined based on the observable market transactions of spot and forward rates. The fair value of these contracts as of June 30, 2016 is included in prepaid and other current assets in the accompanying condensed consolidated balance sheets. The fair value of these contracts as of December 31, 2015 is included in accrued expenses in the accompanying condensed consolidated balance sheets.

The acquisition of MediaMiser includes contingent consideration that requires additional amounts to be paid by the Company based on MediaMiser's revenues and EBITDA during the period from April 1, 2016 to March 31, 2017. The fair value measurement of the contingent consideration obligation is determined using Level 3 unobservable inputs supported by little or no market activity by applying the probability-weighted discounted cash flow approach. The fair value of the contingent consideration as of June 30, 2016 and December 31, 2015 was \$0.5 million, and the Company has recorded this amount in long term obligations in the condensed consolidated financial statements.

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**13. Subsequent Events**

On July 14, 2016, the Company's MediaMiser subsidiary acquired the Agility business from PR Newswire. Agility is a leading global media contact database and media monitoring platform that helps customers target key influencers, amplify content and measure impact. The consideration given after working capital adjustments consisted of \$4.3 million in cash, and is subject to further post-closing adjustment based on working capital as of the closing date. The Company funded the purchase price from its available cash on hand. MediaMiser acquired Agility to foster growth in North America and Europe by bolstering MediaMiser's media intelligence solutions and media databases, improving its media outreach capabilities, and delivering stronger, more data-powered media intelligence to clients. With the acquisition of Agility, MediaMiser is now one of only a handful of companies able to offer a global media contact dataset with integrated workflows for distribution, monitoring and measurement. The acquisition brought to MediaMiser more than 1,500 Agility customers and approximately 50 employees in the US and the UK. Agility had approximately \$5 million in revenues in 2015.

For additional information see the Company's Report on Form 8-K dated July 14, 2016. The information in the financial statements of this Report on Form 10-Q is for the quarterly period ended June 30, 2016, and does not reflect any aspect of the Agility transaction.

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

*Disclosures in this Form 10-Q contain certain forward-looking statements, including without limitation, statements concerning our operations, economic performance, and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "project," "head start," "believe," "expect," "should," "anticipate," "indicate," "point to," "forecast," "likely," "goals," "optimistic," "foster," "estimate" and other similar expressions generally identify forward-looking statements, which speak only as of their dates.*

*These forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties, including without limitation, that contracts may be terminated by clients; projected or committed volumes of work may not materialize; our Innodata Advanced Data Solutions ("IADS") segment is a venture formed in 2011 that has incurred losses since inception and has recorded impairment charges for all of its fixed assets; we currently intend to continue to invest in IADS; the primarily at-will nature of contracts with our Digital Data Solutions (formerly Content Services) clients and the ability of these clients to reduce, delay or cancel projects; continuing Digital Data Solutions segment revenue concentration in a limited number of clients; continuing Digital Data Solutions segment reliance on project-based work; inability to replace projects that are completed, canceled or reduced; difficulty in integrating and deriving synergies from acquisitions, joint venture and strategic investments; potential undiscovered liabilities of companies that we may acquire; depressed market conditions; changes in external market factors; the ability and willingness of our clients and prospective clients to execute business plans which give rise to requirements for our services; changes in our business or growth strategy; the emergence of new or growing competitors; various other competitive and technological factors; and other risks and uncertainties indicated from time to time in our other filings with the Securities and Exchange Commission.*

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

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

### **Business Overview**

Innodata (NASDAQ: INOD) is a global digital services and solutions company. Our technology and services power leading information products and online retail destinations around the world. Our solutions help prestigious enterprises harness the power of digital data to re-imagine how they operate and drive performance. We serve publishers, media and information companies, digital retailers, banks, insurance companies, government agencies and many other industries. Founded in 1988, we comprise a team of 5,000 diverse people in eight countries who are dedicated to delivering services and solutions that help the world embrace digital data as a means of enhancing our lives and transforming our businesses.

We operate in three reporting segments: Digital Data Solutions (DDS), Innodata Advanced Data Solutions (IADS) and Media Intelligence Solutions (MIS). Our DDS segment provides solutions to digital retailers, information services companies, publishers and enterprises that have one or more of the following broad business requirements: development of digital content (including e-books); development of new digital information products; and operational support of existing digital information products and systems. The DDS segment was formerly known as Content Services.

Many of our clients are driving or are responding to rapid and fundamental changes in the way end users discover, consume and create published information. For some of our publishing and information services clients, this means transforming information products from print to digital; for others, it means migrating already-digital products from web-only distribution to multiple-channel distribution that includes mobile and tablet devices and incorporates mobility, social platform and semantic search; and for others still, it means re-tooling pure search-based information products into workflow-embedded analytical tools that combine content with software to enable context-aware decision-making; and for a select number of our information services clients, it means embracing the content-as-a-service model to integrate content with other tools, applications and data. Each of these transformations requires shifts in products, as well as the technology and the operations that support them.

For our enterprise publishing clients, changes in the way end users discover, consume and create published information often necessitates replacing old processes and technologies that generated static, whole documents with new processes and technologies that enable content to reside as modular components which are re-combined dynamically to create up-to-date, product-specific assembly guides, engineering diagrams/schematics, compliance documentation, field operations guides and clinical documentation destined simultaneously for the web, tablets and smartphones.

By blending consulting, technology and operations sourcing, along with deep domain expertise, we provide measurable outcomes for publishing companies, information services companies and enterprises through business transformation, accelerating innovation and efficient operations.

We are one of the largest producers of e-books, serving four of the five leading digital retailers of e-books as well as 80 leading trade, education and professional publishers that sell e-books. We manufacture both standard e-books and interactive e-books in a variety of formats (including EPUB, Mobi and Kindle) and in 12 major languages (including Japanese and Chinese). In addition, we distribute e-books on behalf of publishers and authors to more than 25 e-book retailers across North America, the United Kingdom, Australia and 24 countries in the European Union. Since the fall of 2011, we have produced over 1,000,000 e-book titles.

We help our clients develop high-value information products. Our clients include four of the ten largest information industry companies in the world, spanning financial, legal, healthcare and scientific information.

We work with clients at a strategic business and technology level to address business process and technology challenges related to digital content supply chain optimization and strategy. By aligning operations and technology with business goals, we help businesses accelerate new product development and introduction; control cost; consolidate and leverage technology investment; and obtain benefits of scale.

Many enterprises are embracing new digital information technologies and workflow processes within their operations in order to improve internal decision-support systems. We formed our IADS segment in mid-2011 to design and develop new capabilities to enable clients in the financial services, insurance, medical and healthcare sectors to improve decision-support through digital technologies. We believe that by creating and commercializing innovative business strategies and technology solutions we will be able to accelerate our growth and reduce our revenue volatility.

Our IADS segment operates through our Synodex and docGenix subsidiaries. As of June 30, 2016 we owned 91% of Synodex and 94% of docGenix.

The main focus of the Synodex business is the extraction and classification of data from unstructured medical records in an innovative way to provide improved data service capabilities for insurance underwriting, insurance claims, medical records management and clinical trial support services. Synodex has developed and deployed its APS.Extract<sup>®</sup> product for specific use with life insurance underwriting and claims.

The main focus of the docGenix business is the extraction and classification of data from unstructured legal documents in order to improve an organization's ability to analyze documentation and feed actionable data to downstream applications.

The IADS subsidiaries have incurred losses and have reported minimal revenues since their inception in 2011. Our investment net of revenues in these subsidiaries in the first quarter of 2016 was approximately \$0.7 million (consisting mainly of operating expenses). We wrote off all of the fixed assets of IADS in the third quarter of 2013 and have expensed all investments in IADS since that time. In the immediate future we intend to continue to invest in these subsidiaries net of revenues at the combined rate of \$0.5 to \$0.7 million per quarter.

Our MIS segment operates through our MediaMiser and Bulldog Reporter subsidiaries.

MediaMiser provides media monitoring and analysis software and professional services to several Fortune 500 companies and Canadian government institutions as well as small- and medium-sized businesses. Through web-based and mobile solutions, MediaMiser enables companies to reduce the time and effort required to extract, analyze and share valuable business intelligence from traditional and social media sources. For organizations that prefer to outsource, MediaMiser provides detailed analysis reports and daily media briefings through an expert client services team.

MediaMiser's proprietary technology platform monitors, aggregates, analyzes and shares content from more than 200,000 sources across social, traditional and digital media. The platform includes a unique and patented sentiment analysis engine that identifies whether opinions expressed in a particular document or online text are positive, negative or neutral.

Increasingly, companies looking to market their products, identify market opportunities and manage their reputations are seeking technology and technology-enabled services to help them keep pace with the proliferation of traditional and social media news sources. We believe that MediaMiser's technology platform is well suited to this need and will provide MediaMiser with a competitive advantage as it seeks to expand into new geographical markets and penetrate further into its existing market.

Bulldog Reporter supplies media intelligence news and analysis to public relations and corporate communications professionals with the mission of helping these practitioners achieve competitive performance. Bulldog Reporter publishes the industry's well-known trade journal, Bulldog Reporter's Daily Dog. In addition, it publishes a daily online newsletter—Inside Health Media—that focuses on media relations, and it provides media list and media intelligence services through its Media Pro online directory. Bulldog Reporter presents industry awards competitions—the Bulldog Awards—which recognize excellence in multiple categories including corporate social responsibility, media relations, digital and social marketing, not-for-profit activity and overall outstanding professional performance.

In July 2016, our MediaMiser subsidiary acquired the Agility business from PR Newswire. Agility is a leading global media contact database and media monitoring platform that helps customers target key influencers, amplify content and measure impact. MediaMiser acquired Agility to foster growth in North America and Europe by bolstering MediaMiser's media intelligence solutions and media databases, improving its media outreach capabilities, and delivering stronger, more data-powered media intelligence to clients. With the acquisition of Agility, MediaMiser is now one of only a handful of companies able to offer a global media contact dataset with integrated workflows for distribution, monitoring and measurement. The acquisition brought to MediaMiser more than 1,500 Agility customers and approximately 50 employees in the US and the UK. Agility had approximately \$5 million in revenues in 2015.

Our services are organized and managed around three vectors: a vertical industry focus, a horizontal service/process focus, and a supportive operations focus.

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

Our service/process-aligned groups include engineering personnel and delivery personnel. Our engineering teams are responsible for creating secure and efficient custom workflows and integrating proprietary and third-party technologies to automate manual processes and improve the consistency and quality of our work product. These tools include categorization engines that utilize pattern recognition algorithms based on comprehensive rule sets and related heuristics, data extraction tools that automatically retrieve specific types of information from large data sources, and workflow systems that enable various tasks and activities to be performed across our multiple facilities.

Our globally distributed delivery personnel are responsible for executing our client engagements in accordance with service-level agreements. We deliver services from facilities in the United States, India, the Philippines, Sri Lanka, Israel, Germany and Canada.

Other support groups are responsible for managing diverse enabling functions including human resources, organizational development, network and communications technology infrastructure support and physical infrastructure and facilities management.

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

*Recent Development*

As previously reported, during the first quarter of 2016 the Company became aware of certain potentially improper payments and related transactions made by or at the direction of certain foreign employees of a foreign subsidiary in connection with the inspection of the subsidiary's compliance with local employment-related tax requirements. The Audit Committee initiated an internal investigation into this matter with the assistance of independent counsel and other professionals, and voluntarily contacted the U.S. Department of Justice and the U.S. Securities and Exchange Commission to advise them of the internal investigation. Based upon the Audit Committee's investigation, which we believe has been substantially completed, the amounts in question are not material with respect to the Company's financial condition or results of operations. The employees concerned are no longer employed by the subsidiary. We are unable at this time to predict what, if any, action may be taken by governmental authorities or penalties or remedial measures they may seek. For the second quarter of 2016, we incurred approximately \$1.25 million in legal, professional and related costs and expenses related to the investigation. We expect to incur up to \$225,000 in additional costs relating to the investigation in the third quarter.

*Revenues*

In our DDS segment revenues are recognized based on the quantity delivered or resources utilized and in the period in which the services are performed and once delivery has occurred. Revenues for contracts billed on a time-and-materials basis are recognized as services are performed. Revenues under fixed-fee contracts, which are not significant to the overall revenues, are recognized on the percentage of completion method of accounting, as services are performed or milestones are achieved.

In our IADS segment we recognize revenues primarily based on the quantity delivered, and the period in which services are performed and deliverables are made as per contracts. A portion of our IADS segment revenue is derived from licensing our software and providing access to our hosted software platform. Revenue from such services are recognized monthly when access to the service is provided to the end user and there are no significant remaining obligations, persuasive evidence of an arrangement exists, the fees are fixed or determinable and collection is reasonably assured.

Our MIS segment derives its revenues primarily from subscription arrangements and provision of enriched media analysis services. Revenue from subscriptions are recognized monthly when access to the service is provided to the end user and there are no significant remaining obligations, persuasive evidence of an arrangement exists, the fees are fixed or determinable, and collection is reasonably assured. Revenues from enriched media analysis services are recognized when the services are performed and delivered to the clients.

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

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

*Direct Operating Costs*

Direct operating costs consist of direct payroll, occupancy costs, data center hosting fees, content acquisition costs, depreciation and amortization, travel, telecommunications, computer services and supplies, realized gain (loss) on forward contracts, foreign currency revaluation gain (loss), and other direct expenses that are incurred in providing services to our clients.

*Selling and Administrative Expenses*

Selling and administrative expenses consist of management and administrative salaries, sales and marketing costs including commissions, new services research and related software development, third-party software, advertising and trade conferences, professional fees and consultant costs, and other administrative overhead costs.

*Adjusted EBITDA Performance Metric*

In addition to measures of financial performance presented in our condensed consolidated financial statements, we monitor “Adjusted EBITDA” to help us evaluate our ongoing operating performance and including our ability to operate the business effectively.

We define Adjusted EBITDA as net income (loss) attributable to Innodata Inc. and Subsidiaries in accordance with GAAP before income taxes, depreciation, amortization of intangible assets, impairment charges, stock-based compensation, loss attributable to non-controlling interests and interest income (expense).

We believe Adjusted EBITDA is useful to our management and investors in evaluating our operating performance and for financial and operational decision-making purposes. In particular, it facilitates comparisons of the core operating performance of our company from period to period on a consistent basis and helps us to identify underlying trends in our business. We believe it provides useful information about our operating results, enhances the overall understanding of our past performance and future prospects and allows for greater transparency with respect to key metrics used by the management in our financial and operational decision-making. We use this measure to establish operational goals for managing our business and evaluating our performance.

Adjusted EBITDA has limitations as an analytical tool and should not be considered in isolation or as a substitute for results reported under GAAP. Some of these limitations are:

- Adjusted EBITDA does not reflect tax payments, and such payments reflect a reduction in cash available to us;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs and for our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA excludes the potential dilutive impact of stock-based compensation expense related to our workforce, interest income (expense) and net loss attributable to noncontrolling interests, and these items may represent a reduction or increase in cash available to us;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements; and
- Other companies, including companies in our own industry, may calculate Adjusted EBITDA differently from our calculation, limiting its usefulness as a comparative measure.

Adjusted EBITDA should be considered as a supplement to, and not as a substitute for or superior to, GAAP net income.

The following table shows reconciliation from net loss to Adjusted EBITDA for the periods presented (in thousands):

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	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Adjusted EBITDA:				
Net loss attributable to Innodata Inc. and Subsidiaries	\$ (1,778 )	\$ (799 )	\$ (1,775 )	\$ (2,639 )
Depreciation and amortization	672	709	1,324	1,436
Stock-based compensation	243	274	522	559
Provision for (benefit from) income taxes	258	(254 )	776	301
Interest expense (income), net	16	(19 )	29	(45 )
Non-controlling interests	(92 )	(134 )	(204 )	(280 )
Adjusted EBITDA	\$ (681 )	\$ (223 )	\$ 672	\$ (668 )

## Results of Operations

### Three Months Ended June 30, 2016 and 2015

#### *Revenues*

Total revenues were \$15.6 million for the three months ended June 30, 2016 compared to \$14.1 million for the three months ended June 30, 2015, an increase of approximately \$1.6 million or approximately 11%.

Revenues from the DDS segment were \$13.2 million and \$12.4 million for the three months ended June 30, 2016 and 2015, respectively, an increase of approximately \$0.9 million or approximately 7%. This increase is primarily attributable to increases in volume for several clients, including a ramp-up on a new project for a European publisher, and a ramp-up for a new customer for whom services began in the fourth quarter of 2015.

Revenues from the IADS segment were \$1.2 million for the three months ended June 30, 2016 and \$0.5 million for the three months ended June 30, 2015, an increase of \$0.7 million or 140%. The increase is primarily attributable to an increase in the volume of work from Synodex clients.

Revenues from the MIS segment were \$1.2 million for the three months ended June 30, 2016 and 2015, respectively.

Two clients in the DDS Segment generated approximately 33% of our total revenues for the three months ended June 30, 2016 and 36% of our total revenues for the three months ended June 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the three months ended June 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 53%, respectively, of our total revenues.

*Direct Operating Costs*

Direct operating costs were \$11.7 million and \$11.0 million for the three months ended June 30, 2016 and 2015, respectively, an increase of \$0.7 million or 6%. Direct operating costs as a percentage of total revenues declined to 75% for the three months ended June 30, 2016 compared to 78% for the three months ended June 30, 2015.

Direct operating costs for the DDS segment were approximately \$9.7 million and \$9.3 million for the three months ended June 30, 2016 and 2015, respectively, an increase of \$0.4 million or 4%. The increase in direct operating costs primarily reflects \$150,000 of costs incurred in connection with the internal investigation referred to under Recent Development. Direct operating costs for the DDS segment as a percentage of DDS segment revenues were 73% and 75% for the three months ended June 30, 2016 and 2015, respectively. The decrease in direct operating costs as a percentage of DDS segment revenues primarily reflects an increase in DDS revenues.

Direct operating costs for the IADS segment were \$1.2 million for the three months ended June 30, 2016 and \$1.0 million for the three months ended June 30, 2015, net of intersegment profits. The increase in direct operating costs for the IADS segment primarily reflects an increase in production headcount. Direct operating costs for the IADS segment as a percentage of IADS segment revenues were 103% and 180% for the three months ended June 30, 2016 and 2015, respectively. The decrease in direct operating costs as a percentage of IADS segment revenues was principally attributable to the 114% increase in IADS revenues.

Direct operating costs for the MIS segment were \$0.8 million and \$0.7 million for the three months ended June 30, 2016 and 2015, respectively. Direct operating costs for the MIS segment as a percentage of MIS segment revenues were 62% and 59% for the three months ended June 30, 2016 and 2015, respectively. The increase in direct operating costs as a percentage of MIS segment revenues was principally attributable to an increase in direct operating costs on constant revenues.

#### *Selling and Administrative Expenses*

Selling and administrative expenses were \$5.6 million for the three months ended June 30, 2016 compared to \$4.3 million for the three months ended June 30, 2015, an increase of \$1.3 million or approximately 30%. Selling and administrative expenses as a percentage of total revenues increased to 36% for the three months ended June 30, 2016 compared to 30% for the three months ended June 30, 2015.

Selling and administrative expenses for the DDS segment were \$4.2 million and \$2.9 million in these respective periods, an increase of \$1.3 million or 45%. The increase primarily reflects \$1,250,000 of legal, professional and other costs in connection with the internal investigation referred to above, as well as new hire costs. Selling and administrative expenses for the DDS segment as a percentage of DDS segment revenues increased to 31% for the three months ended June 30, 2016 compared to 24% for the three months ended June 30, 2015.

Selling and administrative expenses for the IADS segment for the respective periods were \$0.3 million and \$0.5 million, net of intersegment profits. The decrease in selling and administrative expenses is on account of cost optimization. Selling and administrative expenses for the IADS segment as a percentage of IADS segment revenues decreased to 29% for the three months ended June 30, 2016 compared to 84% for the three months ended June 30, 2015. The decrease in selling and administrative expenses as a percentage of IADS segment revenues was principally attributable to the 114% increase in IADS revenues.

Selling and administrative expenses for the MIS segment were \$1.1 million and \$0.9 million for the three months ended June 30, 2016 and 2015, respectively. The increase includes \$150,000 of legal and other expenses for the

Agility acquisition referred to in Note 11 to Consolidated Financial Statements. Selling and administrative expenses for the MIS segment as a percentage of MIS segment revenues increased to 83% for the three months ended June 30, 2016 from 75% for the three months ended June 30, 2015.

*Income Taxes*

We recorded a provision for income taxes of \$0.3 million for the three months ended June 30, 2016. Taxes primarily consist of a provision for foreign taxes recorded in accordance with the local tax regulations by our foreign subsidiaries. Effective income tax rates are disproportionate due to the losses incurred by our U.S. entity and our Canadian subsidiary and a valuation allowance recorded on deferred taxes on these entities. Some of our foreign subsidiaries are subject to tax holidays or preferential tax rates which reduce our overall effective tax rate when compared to the U.S. statutory tax rate. In addition, the earnings of our foreign subsidiaries are not subject to tax in the U.S. unless the earnings are repatriated.

We recorded a net benefit from income taxes of \$0.3 million for the three months ended June 30, 2015. We recorded a provision for income taxes in accordance with local tax regulations for our foreign subsidiaries. The provision for income taxes recorded by our foreign subsidiaries was completely offset by a reversal of a tax provision on account of a favorable outcome in two of the tax proceedings of our Indian subsidiary resulting in a benefit from income taxes.

We have a valuation allowance on all of our U.S. deferred tax assets on account of continuing losses incurred by our U.S. entity. In addition, we also have a valuation allowance on deferred tax assets of the MIS segment.

*Net Loss*

We incurred a net loss of \$1.8 million during the three months ended June 30, 2016 compared to a net loss of \$0.8 million during the three months ended June 30, 2015.

Net loss for the DDS segment was \$0.8 million for the three months ended June 30, 2016, compared to a net income of \$0.5 million for the three months ended June 30, 2015, net of intersegment profits. Increased revenues were offset by an increase in direct operating costs and selling and administrative expenses. The change was also caused by an increase in tax expense.

Net loss for the IADS segment was \$0.4 million for the three months ended June 30, 2016 compared to \$0.9 million for the three months ended June 30, 2015, net of intersegment profits. The decline in net loss is primarily due to an increase in revenues.

Net loss for the MIS segment was \$0.6 million for the three months ended June 30, 2016 compared to \$0.4 million for the three months ended June 30, 2015. This change is primarily on account of an increase in the cost structure.

*Adjusted EBITDA*

Adjusted EBITDA for the three months ended June 30, 2016 was a loss of \$0.7 million compared to a loss of \$0.2 million for the three months ended June 30, 2015, an increased loss of \$0.5 million. Adjusted EBITDA for the DDS segment was \$0.1 million and \$0.9 million for the three months ended June 30, 2016 and 2015, respectively, a decrease of \$0.8 million or approximately 89%. Adjusted EBITDA was a loss of \$0.4 million and a loss of \$0.9 million for the IADS segment for the three months ended June 30, 2016 and 2015, respectively. Adjusted EBITDA was a loss of \$0.4 million for the three months ended June 30, 2016 and \$0.2 million three months ended June 30, 2015 for the MIS segment.

**Six Months Ended June 30, 2016 and 2015**

*Revenues*

Total revenues were \$31.3 million for the six months ended June 30, 2016 compared to \$27.9 million for the six months ended June 30, 2015, a decline of approximately \$3.5 million or 12%.

Revenues from the DDS segment were \$26.9 million and \$24.6 million for the six months ended June 30, 2016 and 2015, respectively, an increase of \$2.3 million or 9%. This increase is primarily attributable to e-book related services from one client and increases in volume for several non e-book clients, including a ramp-up on a new project for a European publisher, and a ramp-up for a new customer for whom services began in the fourth quarter of 2015.

Revenues from the IADS segment were \$2.1 million and \$1.0 million for the six months ended June 30, 2016 and 2015, respectively, an increase of \$1.1 million or 117%. The increase is primarily attributable to an increase in the volume of work from Synodex clients.

Revenues from the MIS segment were \$2.3 million for the six months ended June 30, 2016 and 2015.

Two clients in the DDS Segment generated approximately 32% of our total revenues for the six months ended June 30, 2016 and 35% of our total revenues for the six months ended June 30, 2015. Another client in the DDS segment accounted for 10% of our total revenues for the six months ended June 30, 2016 but accounted for less than 10% of our total revenues for the six months ended June 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the six months ended June 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 53%, respectively, of our total revenues

#### *Direct Operating Costs*

Direct operating costs were \$23.2 million and \$22.1 million for the six months ended June 30, 2016 and 2015, respectively, an increase of \$1.1 million or approximately 5%. Direct operating costs as a percentage of total revenues decreased to 74% for the six months ended June 30, 2016 compared to 79% for the six months ended June 30, 2015.

Direct operating costs for the DDS segment were \$19.2 million and \$18.7 million for the six months ended June 30, 2016 and 2015, respectively, an increase of \$0.5 million or 3%. The increase in direct operating costs primarily reflects \$150,000 of costs incurred in connection with the internal investigation referred to under Recent Development, as well as on account of the increase in revenues. Direct operating costs for the DDS segment as a percentage of DDS segment revenues were 71% for the six months ended June 30, 2016 compared to 76% for the six months ended June 30, 2015. The decrease in direct operating costs as a percentage of DDS segment revenues primarily reflects an increase in DDS revenues.

Direct operating costs for the IADS segment were \$2.4 million for the six months ended June 30, 2016 and \$2.1 million for the six months ended June 30, 2015, net of intersegment profits. The increase in direct operating costs for the IADS segment primarily reflects an increase in production headcount. Direct operating costs for the IADS segment as a percentage of IADS segment revenues were 116% and 217% for the six months ended June 30, 2016 and 2015, respectively. The decrease in direct operating costs as a percentage of IADS segment revenues was principally attributable to the 117% increase in IADS revenues.

Direct operating costs for the MIS segment were \$1.6 million and \$1.3 million for the six months ended June 30, 2016 and 2015, respectively. Direct operating costs for the MIS segment as a percentage of MIS segment revenues were 66% and 56% for the six months ended June 30, 2016 and 2015, respectively. The increase in direct operating costs as a percentage of MIS segment revenues was principally attributable to the increase in direct operating costs.

*Selling and Administrative Expenses*

Selling and administrative expenses were \$9.4 million for the six months ended June 30, 2016 compared to \$8.4 million for the six months ended June 30, 2015, an increase of \$1.0 million or approximately 12%. Selling and administrative expenses as a percentage of total revenues were 30% for the six months ended June 30, 2016 and 2015.

Selling and administrative expenses for the DDS segment were \$6.8 million and \$6.0 million in these respective periods, an increase of \$0.8 million or 13%. The increase primarily reflects \$1,250,000 of legal, professional and other costs in connection with the internal investigation referred to above, as well as new hire costs. Selling and administrative expenses for the DDS segment as a percentage of DDS segment revenues increased to 26% for the six months ended June 30, 2016 compared to 24% for the six months ended June 30, 2015.

Selling and administrative expenses for the IADS segment for the respective periods were \$0.7 million and \$0.8 million, net of intersegment profits. The decrease in selling and administrative expenses is on account of cost optimization. Selling and administrative expenses for the IADS segment as a percentage of IADS segment revenues decreased to 35% for the six months ended June 30, 2016 compared to 84% for the six months ended June 30, 2015. The decrease in selling and administrative expenses as a percentage of IADS segment revenues was principally attributable to the 117% increase in IADS revenues.

Selling and administrative expenses for the MIS segment were \$1.9 million and \$1.6 million for the six months ended June 30, 2016 and 2015, respectively. The increase includes \$150,000 of legal and other expenses for the Agility acquisition referred to in Note 11 to Consolidated Financial Statements. Selling and administrative expenses for the MIS segment as a percentage of MIS segment revenues increased to 78% for the six months ended June 30, 2016 from 68% for the six months ended June 30, 2015.

*Income Taxes*

For the six months ended June 30, 2016 we recorded a provision for income taxes of \$0.8 million in accordance with local tax regulations for our foreign subsidiaries. Taxes primarily consist of a provision for foreign taxes recorded in accordance with the local tax regulations by our foreign subsidiaries. Effective income tax rates are disproportionate due to losses incurred by our U.S. entity and our Canadian subsidiary and a valuation allowance recorded on deferred taxes on these entities. Some of our foreign subsidiaries are subject to tax holidays or preferential tax rates which reduce our overall effective tax rate when compared to the U.S. statutory tax rate. In addition, the earnings of our foreign subsidiaries are not subject to tax in the U.S. unless the earnings are repatriated.

For the six months ended June 30, 2015, we recorded a provision for income taxes of \$0.3 million. The provision for income taxes recorded by our foreign subsidiaries was partially offset by a reversal of a tax provision on account of a favorable outcome in two of the tax proceedings of our Indian subsidiary.

We have a valuation allowance on all of our U.S. deferred tax assets on account of continuing losses incurred by our U.S. entity. In addition, we also have a valuation allowance on deferred tax assets of the MIS segment.

*Net Loss*

We generated a net loss of \$1.8 million during the six months ended June 30, 2016 compared to net loss of \$2.6 million during the six months ended June 30, 2015.

Net income for the DDS segment was \$0.3 million for the six months ended June 30, 2016, compared to net loss of \$0.1 million for the six months ended June 30, 2015, net of intersegment profits. Increased revenues were partially offset by an increase in direct operating costs and selling and administrative expenses. The change was also caused by an increase in tax expense.

Net loss for the IADS segment was \$1.0 million for the six months ended June 30, 2016 compared to \$1.9 million for the six months ended June 30, 2015, net of intersegment profits. The decline in net loss is primarily due to an increase in revenues.

Net loss for the MIS segment was \$1.1 million and \$0.6 million for the six months ended June 30, 2016 and 2015, respectively. This change is primarily on account of an increase in the cost structure.

#### *Adjusted EBITDA*

Adjusted EBITDA for the six months ended June 30, 2016 was an income of \$0.7 million compared to loss of \$0.7 million for the six months ended June 30, 2015, an increase of \$1.4 million. Adjusted EBITDA for the DDS segment was \$2.5 million and \$1.5 million for the six months ended June 30, 2016 and 2015, respectively, an increase of \$1.0 million or approximately 67%. Adjusted EBITDA was a loss of \$1.1 million and a loss of \$1.9 million for the IADS segment for the six months ended June 30, 2016 and 2015, respectively. Adjusted EBITDA was a loss of \$0.7 million and a loss of \$0.3 million for the MIS segment for the six months ended June 30, 2016 and 2015, respectively.

#### **Liquidity and Capital Resources**

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

	June 30, 2016	December 31, 2015
Cash and cash equivalents	\$ 24,961	\$ 24,908
Working Capital	24,171	24,959

At June 30, 2016, we had cash and cash equivalents of \$25.0 million, of which \$21.2 million was held by our foreign subsidiaries located in Asia and \$3.8 million was held in the United States. If needed, amounts held by foreign subsidiaries can be repatriated to the United States to satisfy working capital needs of the U.S. entity, but under

current law, such amounts would be subject to United States federal income taxes. As of June 30, 2016, our intent is to permanently reinvest these funds outside the United States, except for \$6.0 million in projected deemed dividends described below. We expect that our cash balances at the end of the third quarter will be in the range of \$19.0 million to \$20.0 million after reflecting payments for the Agility acquisition referred in Note 11 to Consolidated Financial Statements and the payment of accrued costs and expenses for the internal investigation referred to under Recent Development.

We have used, and plan to use, our cash and cash equivalents for (i) investments in IADS which are expected to be at the rate of \$0.5-\$0.7 million per quarter in the immediate future; (ii) investment of \$1.3 million in our MIS segment; (iii) the expansion of our other operations; (iv) general corporate purposes, including working capital; and (v) possible business acquisitions. As of June 30, 2016, we had working capital of approximately \$24.1 million, as compared to working capital of approximately \$25.0 million as of December 31, 2015.

We believe that our existing cash and cash equivalents and internally generated funds will provide sufficient sources of liquidity to satisfy our financial needs for the next 12 months. However, we may curtail or lessen our continuing investments in our IADS segment and other segments, or reduce our operating expenses, if these funds are insufficient and outside financing is not available on terms we find attractive.

In July 2016, our MediaMiser subsidiary acquired Agility business from PR Newswire. The consideration given after working capital adjustments consisted of \$4.3 million in cash, and is subject to further post-closing adjustment based on working capital as of the closing date. We funded the purchase price from our available cash on hand.

We project that during the period from 2016 through 2018 the U.S. entity may not have sufficient cash to pay, in full, amounts that will be payable by it to our Asian operating subsidiaries and that the cash deficit will amount to approximately \$6.0 million. The resulting deferral in payments would result in a deemed dividend that would be taxable income to the U.S. entity and would be set off against its net operating loss carryforwards. We adjusted our deferred tax assets and the corresponding valuation allowance as of June 30, 2016 to reflect the projected deferral. In the second quarter of 2016 the U.S. entity deferred \$2.3 million in payments due to its Asian operating subsidiaries.

In October 2015, we filed a shelf registration statement on Form S-3, which will give us the ability to offer from time to time up to an aggregate of \$70 million of securities, subject to market cap limitations, which may consist of common stock, preferred stock, debt securities, warrants, or units consisting of any of the foregoing. The registration is intended to give us flexibility should financing opportunities arise.

#### *Net Cash Provided By Operating Activities*

Cash provided by our operating activities for the six months ended June 30, 2016 was \$1.2 million, resulting from a net loss of \$2.0 million and adjustments for non-cash items of \$1.7 million and \$1.5 million provided by working capital changes. Adjustments for non-cash items primarily consisted of \$1.3 million for depreciation and amortization, stock option expense of \$0.5 million and reduction in tax provisions of \$0.2 million. Working capital activities primarily consisted of a source of cash of \$1.3 million for an increase in accounts payable and accrued expenses and a source of cash of \$0.5 million for an increase in accrued salaries, wages and related benefits.

Cash provided by our operating activities for the six months ended June 30, 2015 was \$0.5 million, resulting from a net loss of \$2.9 million, adjustments for non-cash items of \$2.1 million, and \$1.3 million provided by working capital changes. Adjustments for non-cash items primarily consisted of \$1.4 million for depreciation and amortization and stock option expense of \$0.6 million. Working capital activities primarily consisted of a source of cash of \$0.6 million as a result of net collections of accounts receivable and a source of cash of \$0.5 million for a decrease in accrued salaries, wages and related benefits.

Our days' sales outstanding (DSO) for the six months ended June 30, 2016 was approximately 55 days as compared to 61 days for the year ended December 31, 2015. We calculate DSO for a reported period by first dividing the total revenues for the period by the average net accounts receivable for the period (which is the sum of the net accounts

receivable at the beginning of the period and the net accounts receivable at the end of the period, divided by two), to yield an amount we refer to as the “accounts receivable turnover.” Then we divide the total number of days within the reported period by the accounts receivable turnover to yield DSO expressed in number of days.

*Net Cash Used In Investing Activities*

For the six months ended June 30, 2016 and 2015, cash used in our investing activities for capital expenditures was \$0.9 million and \$0.3 million that principally consisted of purchases of technology equipment, including workstations and software. We continue to expense all capital expenditures for the IADS segment. During the next twelve months, we anticipate that capital expenditures for ongoing technology, equipment, infrastructure upgrades and development of our proprietary software platform, tools and technologies will approximate \$2.5 to \$3.5 million, a portion of which we may finance.

*Net Cash Used in Financing Activities*

For the six months ended June 30, 2016 and 2015, cash used in financing activities were comprised of total payments of long-term obligations of \$0.3 million and \$0.6 million.

**Contractual Obligations**

The table below summarizes our contractual obligations (in thousands) at June 30, 2016 and the effects that those obligations are expected to have on our liquidity and cash flows in future periods.

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Capital lease	\$372	\$ 287	\$ 85		
Vendor obligations	170	170	-		
Non cancellable operating leases	1,219	416	803		
Total contractual cash obligations	\$1,761	\$ 873	\$ 888	\$ -	\$ -

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

**Inflation, Seasonality and Prevailing Economic Conditions**

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

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

## **Critical Accounting Policies and Estimates**

Our discussion and analysis of our results of operations, liquidity and capital resources is based on our condensed consolidated financial statements which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts and billing adjustments, long-lived assets, intangible assets, goodwill, valuation of deferred tax assets, value of securities underlying stock-based compensation, litigation accruals, pension benefits, purchase price allocation of MediaMiser and Bulldog Reporter, valuation of derivative instruments and estimated accruals for various tax exposures. We base our estimates on historical and anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from our estimates and could have a significant, adverse effect on our results of operations and financial position. For a discussion of our critical accounting policies see Part II, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no material changes to our critical accounting policies during the six months ended June 30, 2016.

## **Recent Accounting Pronouncements**

In May 2014, the FASB issued guidance on revenue from contracts with customers. This update is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This accounting guidance is effective prospectively for annual reporting periods, and interim periods within that period, beginning after December 15, 2017, and early adoption is permitted in the first quarter of 2017. Companies may use either a full retrospective or a modified retrospective approach to adopt the new standard when it takes effect. We have not yet determined the potential effects of the adoption of this standard on our condensed consolidated financial statements.

In November 2015, the FASB issued guidance related to balance sheet classification of deferred taxes. This new guidance requires that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. We do not anticipate that adoption of this standard will have a material impact on our condensed consolidated financial statements.

In February 2016, the FASB issued guidance related to leases. This new guidance requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. This new standard is effective for annual periods beginning after December 15, 2018. Early application is permitted. We have not yet determined the potential effects of the adoption of this standard on our condensed consolidated financial statements.

In March 2016, the FASB issued guidance relating to share-based compensation. This new guidance is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard is effective for annual periods beginning after December 15, 2016. Early application is permitted. We do not anticipate that adoption of this standard will have a material impact on our condensed consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### **Interest rate risk**

Our equipment sales leaseback financing and capital lease transaction carries a fixed interest rate. Thus, as of June 30, 2016 we are not exposed to any market risk due to interest rate fluctuations.

#### **Foreign currency risk**

Although the majority of our revenues is denominated in U.S. dollars, a significant portion of our revenues is denominated in Canadian dollars and Euros. In addition, a significant portion of our expenses, primarily labor expenses in the Philippines, India, Sri Lanka, Germany, Canada and Israel, is incurred in the local currencies of the countries in which we operate. For financial reporting purposes, we translate all non-U.S. denominated transactions into U.S. dollars in accordance with accounting principles generally accepted in the United States. As a result, we are exposed to the risk that fluctuations in the value of these currencies relative to the U.S. dollar could have a direct impact on our revenues and our results of operations.

To mitigate the exposure of fluctuating future cash flows due to changes in foreign exchange rates, we entered into foreign currency forward contracts. These foreign currency forward contracts were entered into with a maximum term of twelve months and have an aggregate notional amount of approximately \$18.6 million as of June 30, 2016. The total unrealized gain on the outstanding hedges was \$0.1 million as of June 30, 2016.

The impact of foreign currency fluctuations will continue to present economic challenges to us and could negatively impact our overall results of operations. A 10% appreciation in the U.S. dollar's value relating to hedged currencies would decrease the forward contracts' fair value by approximately \$1.7 million as of June 30, 2016. Similarly, a 10% depreciation in the U.S. dollar's value relative to hedged currencies would increase the forward contracts' fair value by approximately \$2.1 million. Any increase or decrease in the fair value of our currency exchange-rate-sensitive forward contracts, if utilized, would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying cash flows.

We may continue to enter into these, or other such instruments, in the future to reduce foreign currency exposure to appreciation or depreciation in the value of these foreign currencies.

Other than the aforementioned forward contracts, we have not engaged in any hedging activities nor have we entered into off-balance-sheet transactions or arrangements. In addition, as of June 30, 2016, our foreign locations held cash and cash equivalents totaling approximately \$21.2 million. These assets are exposed to foreign exchange risk arising from changes in foreign exchange rates. At present, we do not enter into any hedging instruments to mitigate foreign exchange risk on such assets; however, we may do so in the future.

#### **Item 4. Controls and Procedures**

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

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In response to the Audit Committee investigation described under “Recent Development” in Item 2 of this Report, the Company intends to conduct supplemental employee training relating to the subject areas of the investigation.

## **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

There were no material changes from the legal proceedings previously disclosed in Part I, Item 3. “Legal Proceedings” in our Annual Report on Form 10-K for the year ended December 31, 2015.

#### **Item 1A. Risk Factors**

The matter set forth under “Recent Development” in Item 2 of this Report is a risk factor that is in addition to the risk factors previously disclosed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

There were no sales of unregistered equity securities during the six months ended June 30, 2016.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

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

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

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101. INS XBRL Instance Document

101. SCH XBRL Taxonomy Extension Schema Document

101. CAL XBRL Taxonomy Extension Calculation Link base Document

101. DEF XBRL Taxonomy Extension Definition Link base Document

101. LAB XBRL Taxonomy Extension Label Link base Document

101. PRE XBRL Taxonomy Extension Presentation Link base Document

**SIGNATURES**

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

INNODATA INC.

Date: August 9, 2016 /s/ Jack Abuhoff  
Jack Abuhoff  
Chairman of the Board,  
Chief Executive Officer and President

Date: August 9, 2016 /s/ O'Neil Nalavadi  
O'Neil Nalavadi  
Senior Vice President  
Chief Financial Officer  
and Principal Accounting Officer