

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from                      to

Commission File Number 001-33287

**INFORMATION SERVICES GROUP, INC.**

(Exact name of Registrant as specified in its charter)

Delaware

20-5261587

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

**Two Stamford Plaza  
281 Tresser Boulevard  
Stamford, CT 06901**

(Address of principal executive offices and zip code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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

**Class**  
Common Stock, \$0.001 par value

**Outstanding at July 25, 2011**  
36,444,735 shares

**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, would, expect, plan, anticipate, believe, estimate, the negative of such terms or other similar expressions. The actual results of ISG may vary materially from those expected or anticipated in these forward-looking statements. The realization of such forward-looking statements may be impacted by certain important unanticipated factors. Because of these and other factors that may affect ISG's operating results, past performance should not be considered as an indicator of future performance, and investors should not use historical results to anticipate results or trends in future periods. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers should carefully review the risk factors described in this and other documents that ISG files from time to time with the Securities and Exchange Commission, including subsequent Current Reports on Form 8-K, Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)****INFORMATION SERVICES GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

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

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

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

## INFORMATION SERVICES GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

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

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

## INFORMATION SERVICES GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

|  | Six Months<br>Ended June 30, |                  |
|--|------------------------------|------------------|
|  | 2011                         | 2010             |
| <b>Cash flows from operating activities</b>  |                              |                  |
| Net (loss) income  | \$ (1,358)                   | \$ 646           |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: |                              |                  |
| Depreciation expense   | 729                          | 745              |
| Amortization of intangibles  | 4,841                        | 3,956            |
| Amortization of deferred financing costs   | 167                          | 182              |
| Compensation costs related to stock-based awards   | 1,627                        | 1,677            |
| Bad debt expense   | 586                          | 50               |
| Deferred tax benefit   | (3,837)                      | (1,898)          |
| (Gain) loss on disposal of furniture, fixtures and equipment                                       | (15)                         | 14               |
| Changes in operating assets and liabilities, net of effects of acquisitions:                       |                              |                  |
| Accounts receivable  | (13,960)                     | (1,005)          |
| Prepaid expense and other current assets   | 585                          | 146              |
| Accounts payable   | (970)                        | (190)            |
| Deferred revenue   | 453                          | 322              |
| Accrued liabilities  | (4,638)                      | (3,887)          |
| <b>Net cash (used in) provided by operating activities</b>   | <b>(15,790)</b>              | <b>758</b>       |
| <b>Cash flows from investing activities</b>  |                              |                  |
| Acquisitions, net of cash acquired   | (13,684)                     |                  |
| Restricted cash  | 5,750                        |                  |
| Proceeds from sale of furniture, fixtures and equipment  | 20                           |                  |
| Purchase of furniture, fixtures and equipment  | (686)                        | (475)            |
| <b>Net cash used in investing activities</b>   | <b>(8,600)</b>               | <b>(475)</b>     |
| <b>Cash flows from financing activities</b>  |                              |                  |
| Principal payments on borrowings   | (4,000)                      | (2,000)          |
| Proceeds from issuance of ESPP shares  | 137                          | 157              |
| <b>Net cash used in financing activities</b>   | <b>(3,863)</b>               | <b>(1,843)</b>   |
| <b>Effect of exchange rate changes on cash</b>   | <b>808</b>                   | <b>(780)</b>     |
| <b>Net decrease in cash and cash equivalents</b>   | <b>(27,445)</b>              | <b>(2,340)</b>   |
| <b>Cash and cash equivalents, beginning of period</b>  | <b>40,301</b>                | <b>42,786</b>    |
| <b>Cash and cash equivalents, end of period</b>  | <b>\$ 12,856</b>             | <b>\$ 40,446</b> |
| <b>Supplemental disclosures of cash flow information:</b>  |                              |                  |
| Noncash financing activities:  |                              |                  |
| Issuance of common stock for acquisition   | 7,980                        |                  |
| Issuance of convertible debt for acquisition   | 6,250                        |                  |

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



**INFORMATION SERVICES GROUP, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(tabular amounts in thousands, except per share data)**

**(unaudited)**

**NOTE 1 DESCRIPTION OF ORGANIZATION AND BUSINESS OPERATIONS**

Information Services Group, Inc. (the Company or ISG ) (Nasdaq: III) is a leading technology insights, market intelligence and advisory services company. We support private and public sector clients in transforming and optimizing their operational environments through strategic consulting, benchmarking and analytics, managed services and research with a focus on information technology, business process transformation and enterprise resource planning.

Our company was founded in 2006. The Company was formed to acquire, through a merger, capital stock exchange, asset or stock acquisition or other similar business combination one or more domestic or international operating businesses. In 2007, ISG consummated its initial public offering and completed the acquisition of TPI Advisory Services Americas, Inc. ( TPI ). TPI operates as a fact-based sourcing advisory firm specializing in the assessment, evaluation, negotiation and management of service contracts between our clients and those clients' outside service providers and their internal shared service organizations.

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

On January 4, 2011, ISG completed the acquisition of Compass. Compass is an independent global provider of business and information technology benchmarking, performance improvement, data and analytics services. It was founded in 1980 and headquartered in the United Kingdom and has 180 employees in 16 countries serving nearly 250 clients worldwide.

On February 10, 2011 ISG completed the acquisition of STA, an independent information technology advisor serving the public sector. STA Consulting advises clients on information technology strategic planning and the acquisition and implementation of new enterprise resource planning and other enterprise administration and management systems. STA was founded in 1997 and is based in Austin, Texas with approximately 40 professionals experienced in information systems consulting in public sector areas such as government operations, IT and project management, contract negotiations, financial management, procurement, human resources and payroll.

**NOTE 2 BASIS OF PRESENTATION**

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The accompanying unaudited condensed consolidated financial statements as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010, have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial statements and pursuant to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are considered necessary for a fair presentation of the financial position of the Company as of June 30, 2011, the results of operations for the three and six months ended June 30, 2011 and 2010 and the cash flows for the six months ended June 30, 2011 and 2010. The condensed consolidated balance sheet as of December 31, 2010 has been derived from the Company's audited consolidated financial statements. Operating results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Certain information and disclosures normally included in the notes to annual financial statements prepared in accordance with GAAP have been omitted from these interim financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the financial statements for the fiscal year ended December 31, 2010, which are included in the Company's 2010 Form 10-K filed with the SEC.

### NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Restricted Cash

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

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

## INFORMATION SERVICES GROUP, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

**Derivative Instruments**

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

**Earnings (Loss) Per Common Share**

Basic earnings (loss) per share is computed by dividing net (loss) income available to common stockholders by the weighted average number of common shares outstanding for the period. The 250,000 STA shares were excluded from basic and diluted earnings per share since the contingency has not been met as of the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would share in the net income of the Company. For the three and six months ended June 30, 2011, the effect of 5.0 million warrants, 0.4 million stock appreciation rights ( SARs ) have not been considered in the diluted earnings per share, since the market price of the stock was less than the exercise price during the period in the computation. In addition, 1.0 million restricted shares have not been considered in the diluted earnings per share calculation for the three and six months ended June 30, 2011, as the effect would be anti-dilutive. For the three and six months ended June 30, 2010, the effect of 35.6 million warrants, 0.5 million SARs and 1.4 million Units (each Unit comprising one common share and one warrant) associated with the Company's IPO underwriters purchase option have not been considered in the diluted earnings per share calculation, since the market price of the Company's common stock was less than the exercise price during the period in the computation. In addition, 0.7 million restricted shares have not been considered in the diluted earnings per share calculation for the three and six months ended June 30, 2010, as the effect would be anti-dilutive.

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

|                                | Three Months<br>Ended June 30, |        | Six Months<br>Ended June 30, |        |
|--------------------------------|--------------------------------|--------|------------------------------|--------|
|                                | 2011                           | 2010   | 2011                         | 2010   |
| <b>Basic:</b>                  |                                |        |                              |        |
| Net income (loss)              | \$ 687                         | \$ 186 | \$ (1,358)                   | \$ 646 |
| Weighted average common shares | 36,376                         | 31,981 | 36,240                       | 31,951 |

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

**Recently Issued Accounting Pronouncements**

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

**INFORMATION SERVICES GROUP, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)**

**(tabular amounts in thousands, except per share data)**

**(unaudited)**

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

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

**NOTE 4 ACQUISITIONS**

*Compass Acquisition*

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

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

The total allocable purchase price consists of the following:

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

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|                                |    |        |
|--------------------------------|----|--------|
| Total allocable purchase price | \$ | 20,078 |
|--------------------------------|----|--------|

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

\*\* The Convertible Notes (the Notes) mature on January 4, 2018 and interest is payable on the outstanding principal amount, computed daily, at the rate of 3.875% per annum on January 31 of each calendar year and on the seventh anniversary of the date of the Notes. The Notes are subject to transfer restrictions until January 31, 2013. If the price of the Company's common stock on the Nasdaq Global Market exceeds \$4 per share for 60 consecutive trading days (the Trigger Event), the holder of the Notes may convert all (but not less than all) of the outstanding principal amount of the Notes into shares of the Company's common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger Event, the Company may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

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

## INFORMATION SERVICES GROUP, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

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

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

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

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

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

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

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|                         |    |       |
|-------------------------|----|-------|
| Total intangible assets | \$ | 5,045 |
|-------------------------|----|-------|

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

### *STA Acquisition*

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

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



## INFORMATION SERVICES GROUP, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

As of the STA Acquisition Date, we have recorded a liability of \$6.7 million representing the fair value of the contingent consideration. This amount was estimated through a valuation model that incorporated industry-based, probability-weighted assumptions related to the achievement of these milestones and thus the likelihood of us making payments. These cash outflow projections have been discounted using a rate of 2.3%, which is the cost of debt financing for market participants.

The total allocable purchase price consists of the following:

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

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

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

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

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

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

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

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

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

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

## INFORMATION SERVICES GROUP, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

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

## NOTE 5 INCOME TAXES

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

As of June 30, 2011, the Company had total unrecognized tax benefits of approximately \$2.3 million of which approximately \$0.5 million of this benefit would impact the Company's effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax provision in its condensed consolidated statement of operations. As of June 30, 2011, the Company's accrual of interest and penalties were \$0.2 million.

## NOTE 6 COMMITMENTS AND CONTINGENCIES

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

**NOTE 7 GOODWILL**

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

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

## INFORMATION SERVICES GROUP, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)

(tabular amounts in thousands, except per share data)

(unaudited)

## NOTE 8 COMPREHENSIVE (LOSS) INCOME

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

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

## NOTE 9 RESTRUCTURING ACCRUAL

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

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

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

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

### NOTE 10 SEGMENT AND GEOGRAPHICAL INFORMATION

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

Geographical revenue information for the segment is as follows:

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

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

**INFORMATION SERVICES GROUP, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(continued)**

**(tabular amounts in thousands, except per share data)**

**(unaudited)**

**NOTE 11 FINANCING ARRANGEMENTS AND LONG-TERM DEBT**

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

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

Additional mandatory principal repayments totaling \$7.0 million and \$10.0 million will be due in 2012 and 2013, respectively, with the remaining principal repayments due in 2014. The final mandatory term loan principal repayment will be due on November 16, 2014, which is the maturity date for the term loan.

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

On January 4, 2011, as part of the consideration for the Share Purchase, the Company issued an aggregate of \$6.3 million in convertible notes to Compass. The Notes mature on January 4, 2018 and interest is payable on the outstanding principal amount, computed daily, at the rate of 3.875% per annum on January 31 of each calendar year and on the seventh anniversary of the date of the Notes. The Notes are subject to transfer restrictions until January 31, 2013. If the price of the Company's common stock on the Nasdaq Global Market exceeds \$4 per share for 60 consecutive trading days (the Trigger Event), the holder of the Notes may convert all (but not less than all) of the outstanding principal amount of the Notes into shares of the Company's common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger Event, the Company may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

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

You should read the following discussion and analysis in conjunction with our financial statements and related notes included elsewhere in this report. Except for historical information, the discussion in this report contains certain forward-looking statements that involve risks and uncertainties. We have based these forward-looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward-looking statements by terminology, such as may, should, could, predict, potential, continue, expect, anticipate, intend, plan, believe, estimate, forecast and similar expressions (or the negative of such expressions.) Forward-looking statements include statements concerning 2011 revenue growth rates and capital expenditures. Forward-looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, the volatility of our stock price, and current competitive conditions. As a result, these statements are subject to various risks and uncertainties. For a discussion of material risks and uncertainties that the Company faces, see the discussion in our 2010 Form 10-K titled "Risk Factors."

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

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

On February 10, 2011 ISG completed the acquisition of STA Consulting, a premier independent information technology advisor serving the public sector. STA Consulting advises clients on information technology strategic planning and the acquisition and implementation of new Enterprise Resource Planning and other enterprise administration and management systems.

***Revenues***

Revenues are generally derived from engagements priced on a time and materials basis as well as various fixed fee projects, and are recorded based on actual time worked and are recognized as the services are performed. Revenues related to materials (mainly out-of-pocket expenses such as airfare, lodging and meals) required during an engagement generally do not include a profit mark-up and can be charged and reimbursed discretely or as part of the overall fee structure. Invoices are issued to clients at least monthly.

The Company operates in one segment, fact-based sourcing advisory services. The Company operates principally in the Americas, Europe, and Asia Pacific. The Company's foreign operations are subject to local government regulations and to the uncertainties of the economic and political conditions of those areas.

Geographical revenue information for the segment is as follows:



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Three Months Ended June 30,  
(in thousands)

| Geographic Area | 2011      | 2010      | Change    | Percent Change |
|-----------------|-----------|-----------|-----------|----------------|
| Americas        | \$ 22,289 | \$ 19,981 | \$ 2,308  | 12%            |
| Europe          | 21,999    | 9,433     | 12,566    | 133%           |
| Asia Pacific    | 5,965     | 3,958     | 2,007     | 51%            |
| Total revenues  | \$ 50,253 | \$ 33,372 | \$ 16,881 | 51%            |

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

**Operating Expenses**

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

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

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

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

Compensation costs consist of a mix of fixed and variable salaries, annual bonuses, benefits and pension plan contributions. A portion of compensation expenses for certain billable employees are allocated between direct costs and selling, general and administrative costs based on relative time spent between billable and non-billable activities. Bonus compensation is determined based on achievement against Company financial and individual targets, and is accrued monthly throughout the year based on management's estimates of target achievement. Statutory and elective pension plans are offered to employees as appropriate. Direct costs also include employee taxes, health insurance, workers compensation and disability insurance.

Sales and marketing costs consist principally of compensation expense related to business development, proposal preparation and delivery and negotiation of new client contracts. Costs also include travel expenses relating to the pursuit of sales opportunities, expenses for hosting periodic client conferences, public relations activities, participation in industry conferences, industry relations, website maintenance and business intelligence activities. The Company maintains a dedicated global marketing function responsible for developing and managing sales campaigns, brand promotion, the TPI Index and assembling proposals.

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

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

Depreciation and amortization expense in the second quarter of 2011 and 2010 was \$2.9 and \$2.3 million, respectively. The increase was primarily due to the acquisitions of Compass and STA. The Company's fixed assets consist of furniture, fixtures, equipment (mainly personal computers) and leasehold improvements. Depreciation expense is generally computed by applying the straight-line method over the estimated useful lives of assets. The Company also capitalizes some costs associated with the purchase and development of internal-use software, system conversions and website development costs. These costs are amortized over the estimated useful life of the software or system.

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

**Other (Expense), Net**

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

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

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

**Income Tax Expense**

The Company's quarterly effective tax rate varies from period to period based on the mix of earnings among the various state and foreign tax jurisdictions in which business is conducted and the level of non-deductible expenses projected to be incurred during the current fiscal year. The Company's effective tax rate for the three months ended June 30, 2011 was 63.6% compared to 41.4% for the three months ended June 30, 2010 primarily due to projected increased impact of state provisions based on revenue. The Company's operations resulted in a pre-tax income of \$1.9 million and a tax provision of \$1.2 million at the 63.6% effective tax rate for the three months ended June 30, 2011.

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

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

**Revenues**

Geographical revenue information for the segment is as follows:

| Geographic Area | Six Months Ended June 30,<br>(in thousands) |      |        | Percent<br>Change |
|-----------------|---|------|--------|-------------------|
|                 | 2011  | 2010 | Change |                   |

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

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

**Operating Expenses**

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

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

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

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

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

**Other (Expense), Net**

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

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

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The decrease was primarily the result of foreign currency related gain offset by higher interest expense as a result of the convertible notes issued in connection with the acquisition of Compass and lower interest income.

### *Income Tax Expense*

The Company's quarterly effective tax rate varies from period to period based on the mix of earnings among the various state and foreign tax jurisdictions in which business is conducted and the level of non-deductible expenses projected to be incurred during the current fiscal year. The Company's effective tax rate for the six months ended June 30, 2011 was 67.0% compared to 42.3% for the six months ended June 30, 2010 primarily due to projected increased impact of state provisions based on revenue. The Company's operations resulted in a pre-tax loss of \$4.1 million and a tax benefit of \$2.8 million at the 67.0% effective tax rate for the six months ended June 30, 2011.

## **LIQUIDITY AND CAPITAL RESOURCES**

### *Liquidity*

The Company's primary sources of liquidity are cash flows from operations, existing cash and cash equivalents and the Company's revolving credit facility. Operating assets and liabilities consist primarily of receivables from billed and unbilled

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services, accounts payable, accrued expenses, and accrued payroll and related benefits. The volume of billings and timing of collections and payments affect these account balances.

As of June 30, 2011, our cash and cash equivalents were \$12.9 million, a net decrease of \$27.4 million from December 31, 2010, which was primarily attributable to the following:

- net cash outflows from operating activities of \$15.8 million;
- acquisitions, net of cash acquired of \$13.7 million;
- capital expenditures for furniture, fixtures and equipment of \$0.7 million; and
- payment of principal amounts due on the debt of \$4.0 million.

### *Capital Resources*

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

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

Additional mandatory principal repayments totaling \$7.0 million and \$10.0 million will be due in 2012 and 2013, respectively, with the remaining principal repayments due in 2014. The final mandatory term loan principal repayment will be due on November 16, 2014, which is the maturity date for the term loan.



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

On January 4, 2011, as part of the consideration for the Share Purchase, the Company issued an aggregate of \$6.3 million in convertible notes to Compass. The Notes mature on January 4, 2018 and interest is payable on the outstanding principal amount, computed daily, at the rate of 3.875% per annum on January 31 of each calendar year and on the seventh anniversary of the date of the Notes. The Notes are subject to transfer restrictions until January 31, 2013. If the price of the Company's common stock on the Nasdaq Global Market exceeds \$4 per share for 60 consecutive trading days (the Trigger Event), the holder of the Notes may convert all (but not less than all) of the outstanding principal amount of the Notes into shares of the Company's common stock at the rate of 1 share for every \$4 in principal amount outstanding. After the Trigger Event, the Company may prepay all or any portion of the outstanding principal amount of the Notes by giving the holder 30 days written notice.

### **Off-Balance Sheet Arrangements**

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

### **Recently Issued Accounting Pronouncements**

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

### **Critical Accounting Policies and Accounting Estimates**

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

evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our Form 10-K, for the year ended December 31, 2010.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company is exposed to financial market risks primarily related to changes in interest rates. A 100 basis point change in interest rates would result in an annual change in the results of operations of \$0.7 million pre-tax.

We operate in a number of international areas which exposes us to significant foreign currency exchange rate risk. We have significant international revenue, which is generally collected in local currency. As of June 30, 2011, the Company had no outstanding forward exchange contracts or other derivative instruments for hedging or speculative purposes. The percentage of total revenues generated outside the Americas increased from 22% in 2004 to 42% in 2010. It is expected that our international revenues will continue to grow as European, Asian and other markets adopt sourcing solutions and as a result of our acquisition of Compass. We recorded a foreign exchange transaction gain of \$0.2 million for the six months ended June 30, 2011. The translation of our revenues into U.S. dollars, as well as our costs of operating internationally, may adversely affect our business, results of operations and financial condition.

The Company has not invested in foreign operations in highly inflationary economies; however, we may do so in future periods.

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

The Company's 20 largest clients accounted for approximately 45% of revenue in 2010 and 44% in 2009. In particular, revenues from clients in the automobile sector collectively accounted for approximately 15% of our 2010 annual revenue. In addition, our large clients generally maintain sizable receivable balances at any given time and our ability to collect such receivables could be jeopardized if such client fails to remain a viable business.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the

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effectiveness of our disclosure controls and procedures as of June 30, 2011, as required by the Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2011.

### **Internal Control Over Financial Reporting**

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

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None.

**ITEM 1A. RISK FACTORS**

The risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 have not materially changed.

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

**Issuer Purchases of Equity Securities**

There were no repurchases that were made during the three months ended June 30, 2011.

**ITEM 4. (REMOVED AND RESERVED)**

**ITEM 6. EXHIBITS**

The following exhibits are filed as part of this report:

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 31.1 *                | Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).   |
| 31.2 *                | Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a).   |
| 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 *                 | The following materials from ISG's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Condensed Statements of Operations for the three and six months ended June 30, 2011 and 2010, (ii) the Consolidated Condensed Balance Sheets at June 30, 2011 and December 31, 2010, (iii) |

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Consolidated Condensed Statements of Cash Flows for the six months ended June 30, 2011 and 2010, and (iv) Notes to Consolidated Condensed Financial Statements for the six months ended June 30, 2011. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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\* Filed herewith.

**SIGNATURES**

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

**INFORMATION SERVICES GROUP, INC.**

Date: August 9, 2011

/s/ Michael P. Connors  
Michael P. Connors, Chairman of the  
Board and Chief Executive Officer

Date: August 9, 2011

/s/ David E. Berger  
David E. Berger, Executive Vice  
President and Chief Financial Officer