

INNODATA ISOGEN INC
Form 10-K
March 31, 2006

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

FORM 10-K

(Mark One)

Annual report under section 13 or 15(d) of the securities exchange act of 1934
For the fiscal year ended December 31, 2005

Transition report under section 13 or 15(d) of the securities exchange act of 1934

Commission file number 0-22196

INNODATA ISOGEN, 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) 488-1200

(Registrant's telephone number)

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, \$.01 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 past twelve 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 if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter **\$60,000,000**

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

24,086,603 shares of common stock, \$.01 par value, as of February 28, 2006.

DOCUMENTS INCORPORATED BY REFERENCE
[SEE INDEX TO EXHIBITS]

PART I

Disclosures in this Form 10-K 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 “estimate,” “believe,” “expect,” and “anticipate” 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, continuing revenue concentration in a limited number of clients, continuing reliance on project-based work, worsening of 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 digital content and professional services in knowledge processing, difficulty in integrating and deriving synergies from acquisitions, potential undiscovered liabilities of companies that we acquire, 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 set forth under “Risk Factors.”

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 release 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.

Item 1. Description of Business.

General

We provide business services that help organizations create, manage, use and distribute information more effectively and economically.

Our services encompass outsourced content services and information technology (IT) professional services, which constitute separate reporting segments. Our outsourced content offerings consist of fabrication services for digitization, imaging, data conversion and composition, XML and other mark-ups, translation and localization; and knowledge services for adding value to a client's content. Our IT professional offerings focus on the design, implementation, integration and deployment of systems used to author, manage and distribute content.

Outsourced content services represented 87%, 81% and 82% of total revenue in each of the three years ended December 31, 2005, respectively. Outsourced content services for business processes that we anticipate a client will require for an indefinite period generate what we regard as recurring revenues. Approximately 58% and 47% of our revenues were recurring in the years ended December 31, 2005 and 2004, respectively. A substantial majority of our IT professional services is provided on a project basis that generates non-recurring revenues.

In 2005, we provided our services to approximately 100 clients primarily in four content-intensive sectors.

- Publishing, media and information services, including EBSCO and Reed Elsevier;
- Global 2000 enterprises, including Hamilton Sundstrand and Lockheed Martin;
- Educational and cultural institutions, including Cornell University

Government agencies

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We work directly with existing and prospective clients to identify and refine their objectives, and to design, implement, integrate and deploy new and improved solutions to satisfy those objectives. We believe we provide high quality, value-added services to our clients on a timely basis and have developed a close relationship with them as a result. To enhance those relationships, we provide project support 24 hours a day, seven days a week, through our Asia-based customer service center, and we maintain sales, service and strategic support in North America and Europe in proximity to the operations of most of our clients.

One client accounted for 27%, 23% and 33% of our total revenues for each of the three years ended December 31, 2005, respectively. One other client accounted for 12% and 31% of our revenues for the years ended December 31, 2005 and 2004, respectively. No other client accounted for 10% or more of our total revenues during these periods. Revenues from clients located in foreign countries (principally in Europe) accounted for 35%, 30% and 47% of our total revenues for each of the three years ended December 31, 2005, respectively.

A substantial portion of the services we provide to our clients is subject to our clients' needs. Our agreements with clients are in most cases terminable on 30 to 90 days' notice and are typically subject to client requirements.

We are headquartered in Hackensack, New Jersey, just outside New York City. We have two additional solutions centers in North America, seven production facilities in Asia (the Philippines, India and Sri Lanka) and a technology and tools development center in India. We were incorporated in Delaware in 1988.

Innodata Isogen's Services

Outsourced Content Services. We group our outsourced content services into two categories: fabrication services and knowledge services.

Fabrication Services. Our fabrication services include digitization, imaging, data conversion and composition services, XML and mark-up services, as well as translation and localization services. We use leading-edge technologies to capture our clients' relevant content and convert it into XML and other related mark-up standards. These technologies include high-speed scanning; a variety of commercial and proprietary optical/intelligent character recognition, or OCR/ICR, applications; structured workflow processes; and proprietary applications and tools designed to create meaningful, accurate and consistent data.

To convert the captured content to XML, tags are inserted within the content to provide a marker that computers can process. Our proprietary technology includes production-grade, auto-tagging applications that utilize pattern recognition algorithms based on comprehensive rule sets and related heuristics. This technology enables the mass creation or conversion of XML content from complex, unstructured data or content.

We price our digitization, content conversion and composition services based on the quantity delivered or resources utilized.

As an example, we built, for a secondary publisher, a searchable online archive that contains the back runs of three historical newspaper publications. The archive shows each newspaper page as a high-resolution image that can be magnified over 200% of its normal size. Each issue is digitally reproduced from cover to cover, including news stories and editorials, graphics and advertisements that bring history to life. Using the latest technology, we imaged the backfile and saved each page as a high-resolution, bitonal TIFF image. We captured the text of every headline, byline and story on every page using OCR, tagged the key information in XML and saved the text and image files for storage in an XML repository.

Knowledge Services. Our knowledge services add value to a client's content. These services include content creation and enhancement, taxonomy and controlled vocabulary development, hyperlinking, indexing, abstracting, copyediting

and general editorial services, including the provision of synopses and annotations. We also provide editorial and research services that cover a wide spectrum of expertise, including medicine, law, engineering, management, finance, science and the humanities. To provide these services, we have organized knowledge teams that consist of a number of educated and highly trained people with expertise in the relevant subject. We typically price our knowledge services based on the quantity delivered or resources utilized.

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As an example, a major publisher of scientific, technical and medical information sought to build one of the world's largest databases of scientific journal citations and references. We created records of nearly 15,000 journal titles going back almost 13 years, encoded in a way that supported integrated web searches and seamless linking. Under a long-term engagement, we maintain the database with daily updates, managing on behalf of our client a production process in which we aggregate, digitize, convert and enhance data.

IT Professional Services. Clients that use our IT professional services typically require publishing, performance support or process automation systems that enable multiple authors to collaborate on content and enable multiple products to be generated from single-source XML repositories. Projects vary in size and duration. Our IT professional services are typically provided on a project basis that involves a defined task that, upon completion, does not generate any significant amount of continuing revenues. We frequently work on-site at clients to develop specifications and define requirements and to interact with end-users of the application. Detailed design, implementation and testing are generally performed at our offices in Dallas and Austin, Texas, as well as offshore at our office in Gurgaon, India.

Our IT professional services focus on the design, implementation, integration and deployment of systems used to author, manage and distribute content. We group these services into four categories: consulting; systems integration; custom application development; and other IT professional services, including applications maintenance, support, evaluation, implementation and training.

Consulting. We offer consulting services that focus on evaluating, advising, creating, overseeing or reviewing processes and/or technology designs that are necessary for a client to improve its management, use or distribution of information. We assist our clients by first understanding their business objectives and then analyzing and recommending the appropriate hardware and software specifications, as well as the process and engineering changes that will fulfill these objectives. Our consultants have a broad mix of functional and industry expertise. Our highly skilled process analysts, workflow architects and project managers enable clients to outsource to us their entire content operations, and thereby enhance the client's ability to manage, use and distribute the content.

As an example, a major defense contractor was awarded a multi-billion dollar military contract to build a new war plane. The military required that the technical documentation be delivered in electronic format and be useable by field technicians using handheld PDAs, as well as by pilots in the cockpit. The defense contractor hired us to recommend an XML-based publishing approach. Over several months, our team made several recommendations and redesigned the client's core business processes and systems architecture to achieve its objectives, including the ability to support high-volume, link-intensive data. We were then engaged by the client to develop the system. The completed system provided an end-to-end workflow that included link management, support for complex graphics, customized backend databases to support fast search and retrieval and customized user interfaces.

Systems Integration. Our systems integration services include the integration of disparate authoring tools, content and knowledge management systems and composition tools into an overall IT infrastructure, and also include the development of software that enhances the compatibility among various components of the overall IT infrastructure. We also undertake the management of programs and vendors during this process. Many of our systems integration projects involve organizations that are migrating to XML and other standards-based publishing systems or are seeking to integrate disparate data sources into a common environment. Our IT projects often include content analysis and the development of information architectures.

For example, one of the world's most successful IT equipment manufacturers was faced with the challenge of producing increasingly complex technical documentation faster, in more languages and across multiple platforms, as well as in print. This was necessary because of shortening product life cycles and the desire to market products in remote global markets. Over a 12-month period, our team of information architects and developers provided strategy and process consulting, product evaluation and information engineering services. We addressed complex content authoring, translation and localization and document rendition requirements. The result was a completely

re-engineered standards-based product documentation system that enabled our client to easily revise and re-use content and translate that content into 35 languages seamlessly. We improved our client's time-to-market by significantly reducing the turnaround time for documentation and revisions, and substantially reduced overall product documentation costs. Our team of two domestic project managers and five offshore developers continue to provide the client ongoing systems enhancement and maintenance under a long-term engagement.

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Custom Application Development. Our custom application development services help our clients create new applications and enhance the functionalities of our clients' existing software applications. We design systems, develop software and run pilots.

Our application development services span the entire range of client server and Internet technologies. Our IT professional services staff is expert in XML and related information standards, as well as in emerging computing platforms. Our programmers are skilled in a range of programming languages and in a diverse set of application program interfaces, applications servers and database technologies.

As an example, a client in the information services industry needed to build an enterprise-scale publishing platform for a new online information service using the latest knowledge processing technologies. Our team of onshore and offshore technologists designed and built the platform over a period of several months, including authoring and classification workflow systems, backend database and user interface. Our content services department aggregated, digitized and enhanced multiple gigabytes of data for the successful product pilot. Our single program manager coordinated the efforts of our IT professional services team, our outsourced content services team and other vendors on-site at the client's location.

Other IT Professional Services. We assist our clients in the evaluation and implementation of software packages developed by third party vendors. We specialize in enterprise content management systems developed by several vendors, including: Documentum, Content@, XHive Corporation and Vasont Systems; and document authoring systems developed by vendors including Arbortext and Blast Radius; publishing tools developed by vendors including TopLeaf, Antenna House and FrameMaker; as well as various content analysis and extraction tools.

We provide support for our clients' content-related applications, ensuring that systems remain operational and responsive to changing user requirements. In doing so, we are often able to enhance processes and improve service levels. Through our domestic, on-site and offshore delivery model, we provide a range of support services to our clients.

Sales and Marketing

We have four executive-level business development professionals and eight full-time sales personnel and are targeting to increase our full-time salesperson headcount by the end of 2006. Historically, our sales efforts depended heavily on senior management. We are transitioning to a more structured direct sales model in which we implement additional sales infrastructure, add dedicated sales support personnel and hire additional sales persons. In this model, our executive-level business development professionals will continue to manage key client relationships through targeted interaction with our clients' senior management, while sales professionals will be responsible for identifying prospective clients and executing day-to-day sales strategies.

Our sales organization is responsible for qualifying and otherwise pursuing prospects, securing direct personal access to decision makers at existing and prospective clients and obtaining orders for our services and solutions. Our sales professionals work directly with clients to identify their requirements and with our engineering teams to define the solutions that best fit our clients' specific needs.

Sales activities include the design and generation of presentations and proposals, account and client relationship management and the organization of account activities.

Consulting personnel from our project analysis group and our engineering services group closely support our direct sales effort. These individuals assist the sales force in understanding the technical needs of clients and providing responses to these needs, including demonstrations, prototypes, pricing quotations and time estimates. In addition, account managers from our customer service group support our direct sales effort by providing ongoing project-level, post-sale support to our clients.

We constantly seek to expand the nature and scope of our engagements with existing clients by increasing the volume of our business and extending the breadth and value of services offered.

Our marketing organization is responsible for developing and increasing the visibility and awareness of our brand and our service offerings; defining and communicating our value proposition; and generating qualified, early-stage leads and furnishing effective sales support tools.

Over the past 12 months, we have created a partner program pursuant to which we have formed collaborative relationships with selected leading software vendors and service providers in many of our key markets. We believe that our partner program is an important way for our sales force to generate more and better-quality leads. Furthermore, the partner program helps us gain technical insights that allow us to better evaluate the effectiveness of the various tools that we recommend to our clients.

Primary marketing outreach activities include event marketing (including exhibiting at trade shows, conferences and seminars); direct and database marketing; public and media relations (including speaking engagements and active participation in industry and technical standard bodies); and web marketing (including search engine optimization, search engine marketing and the maintenance and continued development of external web sites).

Research and Development

In 2005 we spent approximately \$770,000 on research and development. We did not spend any significant amounts for research and development in 2004 and 2003.

Competition

The market for outsourced content services is highly competitive, fragmented and intense. Several of our major competitors are SPI Technologies, Apex CoVantage, Techbooks and Jouve. However, we are not aware of any single competitor that provides the same comprehensive range of outsourced content services as we do. We believe that we also compete successfully by offering high quality services and favorable pricing by leveraging our technical skills, IT infrastructure, process knowledge, offshore model and economies of scale. Our competitive advantages are especially attractive to clients for undertakings that are technically sophisticated, sizable in scope or scale, or that require a highly fail-safe environment with technology redundancy. We also believe that the timeliness with which we provide our services enables our clients to reduce the time it takes for them to release their products to the market, thereby providing a competitive advantage to the client.

A number of large and mid-sized technology and business consulting practices compete with our IT professional services by offering content-related integration and consulting services as part of their broad and generalized offerings. Major companies such as IBM, EDS, Bearing Point, Accenture, Booz Allen and others compete for entire content supply chain dollars, and Thomas Technology Solutions and RivCom are also engaged in this business. However, there are few firms that focus exclusively on our niche, and most of these firms have less capacity and a narrower strategic focus on the content supply chain.

As a provider of outsourced content services and IT professional services, we also compete at times with in-house personnel at existing or prospective clients who may attempt to duplicate our services in-house.

Some of our competitors have longer operating histories, significantly greater financial, human, technical and other resources and greater name recognition than we do, and we cannot assure you that we will continue to compete effectively with them.

There are relatively few barriers preventing companies from competing with us. We do not own any patented technology that would preclude or inhibit others from entering our market.

Employees

As of December 31, 2005, we employed 87 persons in the United States and Europe and approximately 6,000 persons in five production facilities in the Philippines, one production facility in Sri Lanka, one production facility in India and a technology and tools development center in India. Most of our employees have graduated from at least a two-year college program. Many of our employees hold advanced degrees in law, business, technology, medicine and social sciences. No employees are currently represented by a labor union, and we believe that our relations with our employees are satisfactory.

Item 1A. Risk Factors.

We have historically relied on a very limited number of clients that have accounted for a significant portion of our revenues and our results of operations could be adversely affected if we lose one or more of these significant clients.

We have historically relied on a very limited number of clients that have accounted for a significant portion of our revenues. One client accounted for 27%, 23% and 33% of our total revenues for the years ended December 31, 2005, 2004 and 2003, respectively. One other client accounted for 12% and 31% of our revenues for the years ended December 31, 2005 and 2004, respectively. We may lose any of these or our other major clients as a result of our failure to meet or satisfy our clients' requirements, the completion or termination of a project or engagement, or the selection of another service provider.

In addition, the revenues we generate from our major clients may decline or grow at a slower rate in future periods than in the past. If we lose any of our significant clients, our revenues and results of operations could be adversely affected and we may incur a loss from operations. Our services are typically subject to client requirements, and in most cases are terminable upon 30 to 90 days' notice.

A significant portion of our services is provided on a non-recurring basis for specific projects, and our inability to replace large projects when they are completed has adversely affected, and could in the future adversely affect, our revenues and results of operations.

We provide a portion of our services for specific projects that generate revenues that terminate on completion of a defined task and we regard these revenues as non-recurring. Non-recurring revenues derived from these project-based arrangements accounted for approximately 42% of our total revenues for the year ended December 31, 2005 and approximately 53% of our total revenues for the year ended December 31, 2004. While we seek wherever possible to counterbalance periodic declines in revenues on completion of large projects with new arrangements to provide services to the same client or others, we were not able in 2005 to avoid declines in revenues when large projects were completed. Our inability to obtain sufficient new projects to counterbalance any decreases in such work adversely affected our revenues and results of operations in 2005 and may adversely affect our future revenues and results of operations.

A large portion of our accounts receivable is payable by a limited number of clients; the inability of any of these clients to pay its accounts receivable would adversely affect our results of operations.

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Several significant clients account for a large percentage of our accounts receivable. As of December 31, 2005, 37%, or \$2.7 million, of our accounts receivable was due from one client. If any of these clients were unable, or refuse, for any reason, to pay our accounts receivable, our results of operations would be adversely affected.

Quarterly fluctuations in our results of operations could make financial forecasting difficult and could negatively affect our stock price.

We have experienced, and expect to continue to experience, significant fluctuations in our quarterly revenues and results of operations. During the past eight quarters, our net income ranged from a loss of approximately \$900,000 to a profit of approximately \$3.1 million.

Our quarterly operating results are also subject to certain seasonal fluctuations. Our fourth and first quarters include the months of December and January, when billable services activity by professional staff, as well as engagement decisions by clients, may be reduced due to client budget planning cycles. Demand for our services generally may be lower in the fourth quarter due to reduced activity during the holiday season and fewer working days for our Philippines-based staff during this period. These and other seasonal factors may contribute to fluctuations in our results of operations from quarter to quarter.

We compete in highly competitive markets that have low barriers to entry.

The markets for our services are highly competitive and fragmented. We may not be able to compete successfully against our competitors in the future. Some of our competitors have longer operating histories, significantly greater financial, human, technical and other resources and greater name recognition than we do. If we fail to be competitive with these companies in the future, we may lose market share, which could adversely affect our revenues and results of operations.

There are relatively few barriers preventing companies from competing with us. We do not own any patented technology that would preclude or inhibit others from entering our market. As a result, new market entrants also pose a threat to our business. We also compete with in-house personnel at current and prospective clients, who may attempt to duplicate our services using in-house personnel. We cannot assure you that our clients will outsource more of their needs to us in the future, or that they will not choose to provide internally the services that they currently obtain from us. If we are not able to compete effectively, our revenues and results of operations could be adversely affected.

We are the subject of continuing litigation, including litigation by certain of our former employees.

We are subject to various legal proceedings and claims which arise in the ordinary course of business. In addition, in connection with the cessation of all operations at certain of our foreign subsidiaries, certain former employees have filed various actions against one of our Philippine subsidiaries and have purported also to sue us and certain of our officers and directors. An unfavorable ruling in any of these proceedings could adversely affect our financial condition and results of operations. See "Legal Proceedings."

Our international operations subject us to risks inherent in doing business on an international level, any of which could increase our costs and hinder our growth.

The major part of our operations is carried on in the Philippines, India and Sri Lanka, while our headquarters are in the United States and our clients are primarily located in North America and Europe. While we do not depend on revenues from sources internal to the countries in which we operate, we are nevertheless subject to certain adverse economic factors relating to overseas economies generally, including inflation, external debt, a negative balance of trade and underemployment. Other risks associated with our international business activities include:

difficulties in staffing international projects and managing international operations, including overcoming logistical and communications challenges;

- local competition, particularly in the Philippines, India and Sri Lanka;
- imposition of public sector controls;
- trade and tariff restrictions;
- price or exchange controls;
- currency control regulations;
- foreign tax consequences;
- labor disputes and related litigation and liability;
- limitations on repatriation of earnings; and
- the burdens of complying with a wide variety of foreign laws and regulations.

One or more of these factors could adversely affect our business and results of operations.

Our international operations subject us to currency exchange fluctuations, which could adversely affect our results of operations.

To date, most of our revenues have been denominated in U.S. dollars, while a significant portion of our expenses, primarily labor expenses in the Philippines, India and Sri Lanka, is incurred in the local currencies of countries in which we operate. For financial reporting purposes, we translate all non-United States denominated transactions into 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 dollar could increase the dollar cost of our operations and therefore adversely affect our results of operations.

The Philippines has historically experienced high rates of inflation and major fluctuations in the exchange rate between the Philippine peso and the U.S. dollar. Continuing inflation without a corresponding devaluation of the peso against the dollar, or any other increase in the value of the peso relative to the dollar, could adversely affect our results of operations. Since 1997, we have not purchased foreign currency futures contracts for pesos, but we may choose to do so in the future.

New regulation of the Internal Revenue Service may impose significant U.S. income taxes on our subsidiaries in the Philippines.

Our subsidiaries incorporated in the Philippines were domesticated in Delaware as limited liability companies. In August 2004, the Internal Revenue Service promulgated regulations, effective August 12, 2004, that treat certain companies incorporated in foreign jurisdictions and also domesticated as Delaware limited liability companies as U.S. corporations for U.S. federal income tax purposes. We have effected certain filings with the Secretary of State of the State of Delaware to ensure that these subsidiaries are no longer domesticated in Delaware. As a result, commencing January 1, 2005, these subsidiaries are not treated as U.S. corporations for U.S. federal income tax purposes under the regulations and are not subject to U.S. federal income taxes commencing as of such date.

In the preamble to such regulations, the IRS expressed its view that dual registered companies described in the preceding sentence are also treated as U.S. corporations for U.S. federal income tax purposes for periods prior to August 12, 2004. On January 30, 2006, the IRS issued its final regulations, stating that neither the temporary regulations nor these final regulations are retroactive. The earliest date that any entity is subject to these regulations is August 12, 2004. For periods prior to the date these final regulations apply (i.e., prior to August 12, 2004), the classification of dually chartered entities is governed by the pre-existing regulations. We believe that our historic treatment of these subsidiaries as not having been required to pay taxes in the United States for the period prior to August 12, 2004 is correct, and would vigorously defend its treatment if challenged. As such, we have made no provision for U.S. taxes in its financial statements for these entities for the periods prior to August 12, 2004.

Furthermore, we cannot assure you that the Internal Revenue Service will not assert other positions with respect to the foregoing matters, including positions with respect to our treatment of the tax consequences of the termination of the status of our Philippines subsidiaries as Delaware limited liability companies, that, if successful, could increase materially our liability for U.S. federal income taxes.

If certain tax authorities in North America and Europe challenge the manner in which we allocate our profits, our net income will decrease.

We benefit from tax incentives in certain jurisdictions where tax incentives have been extended to encourage foreign investment or where income tax rates are low. Our taxes could increase if these tax incentives are not renewed upon expiration, or if tax rates applicable to us are increased. Substantially all of the services provided by our Asian subsidiaries are performed on behalf of clients based in North America and Europe. We believe that profits from our Asian operations are not sufficiently connected to jurisdictions in North America or Europe to give rise to income taxation in those jurisdictions, other than U.S. taxes that may arise as the result of the former status of our Philippine subsidiaries as Delaware limited liability companies as described in the preceding risk factor. Tax authorities in jurisdictions in North America and Europe could, however, challenge the manner in which we allocate our profits among our subsidiaries, and we may not prevail in this type of challenge. If our Asian profits became subject to income taxes in these other jurisdictions, our worldwide effective tax rate could increase, thereby decreasing our net income.

An expiration or termination of our current tax holidays could adversely affect our results of operations.

We currently benefit from income tax holiday incentives in the Philippines, India and Sri Lanka which provide that we pay reduced income taxes in those jurisdictions for a fixed period of time that varies depending on the jurisdiction. An expiration or termination of our current tax holidays could substantially increase our worldwide effective tax rate, thereby decreasing our net income and adversely affecting our results of operations.

Regional instability in the Philippines, India and Sri Lanka could adversely affect business conditions in those regions, which could disrupt our operations and adversely affect our business and results of operations.

We conduct a majority of our operations in the Philippines, India and Sri Lanka. These operations remain vulnerable to political unrest. Political instability could adversely affect the legal environment for our business activities in those regions.

In particular, the Philippines has experienced ongoing problems with insurgents. The Abu Sayyaf group of kidnapers, which is purported to have ties to the Al Qaeda terrorist organization, is concentrated on Basilan Island. While Basilan Island is not near our facilities and the government of the Philippines has taken action to eradicate this group, we cannot assure you that these efforts will be successful or that the Abu Sayyaf group will not attempt to disrupt activities or commit terrorist acts in other areas of the Philippines or South Asia.

In recent years there have been military confrontations between India and Pakistan that have occurred in the region of Kashmir and along the India-Pakistan border. In addition, in recent years there has been civil unrest in Sri Lanka.

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Further political tensions and an escalation in these hostilities could adversely affect our Philippines, Indian and Sri Lankan based operations and therefore adversely affect our revenues and results of operations.

Terrorist attacks or a war could adversely affect our results of operations.

Terrorist attacks, such as the attacks of September 11, 2001 in the United States, and other acts of violence or war, such as the conflict in Iraq, could affect us or our clients by disrupting normal business practices for extended periods of time and reducing business confidence. In addition, these attacks may make travel more difficult and may effectively curtail our ability to serve our clients' needs, any of which could adversely affect our results of operations.

It is unlikely that we will pay dividends.

We have not paid any cash dividends since our inception and do not anticipate paying any cash dividends in the foreseeable future. We expect that our earnings, if any, will be used to finance our growth.

Item 2. Description of Property.

Our services are primarily performed from our Hackensack, New Jersey headquarters, our Dallas and Austin, Texas offices, and seven overseas facilities, all of which are leased. In addition, we have a technology and tools development facility in Gurgaon, India, which is also leased. The square footage of all our leased properties is approximately 405,000. Rental payments on property leases were approximately \$2.0 million in 2005.

Item 3. Legal Proceedings.

The Innodata Employees Association (IDEA), Jomarie Deles and other complainants have sued one of our Philippines subsidiaries, and have purported also to sue us and certain of our officers and directors, in *Innodata Philippines Employees Association (IDEA) v Innodata Philippines, Inc.* (filed July 27, 2001 at the National Conciliation and Mediation Board of the Philippine Department of Labor and Employment in Manila); *Innodata Employees Association (IDEA), Jomarie Deles, et al v. Innodata Philippines, Inc.* (filed July 1, 2002 in the National Labor Relations Commission of the Republic of the Philippines in Manila); and in related cases and proceedings filed in the Philippines Supreme Court, the Philippine Court of Appeals and the Philippines Department of Labor and Employment. Complainants seek to require reinstatement of employment and to recover back wages for an allegedly illegal facility closing on June 7, 2002 based on the terms of a collective bargaining agreement with this subsidiary. If complainants' claims had merit they could be entitled to back wages of up to \$5.0 million for the period from June 7, 2002 to June 6, 2005, consistent with prevailing jurisprudence. After consultation with counsel, we believe that the complainants' claims are without merit and we intend to defend against them vigorously.

In addition, we are subject to various legal proceedings and claims which arise in the ordinary course of business. While we currently believe that the ultimate outcome of these proceedings will not have a material adverse effect on our financial condition or results of operations, litigation is subject to inherent uncertainties. Were an unfavorable ruling to occur, it could have a material adverse effect on our financial condition and results of operations.

Item 4. Submission of Matters to a Vote of Security Holders-None.

PART II**Item 5. Market for Common Equity and Related Stockholder Matters.**

Innodata Isogen, Inc. (the “Company”) Common Stock is quoted on the Nasdaq National Market System under the symbol “INOD.” On February 28, 2006, there were 114 stockholders of record of the Company’s Common Stock based on information provided by the Company's transfer agent. Virtually all of the Company’s publicly held shares are held in “street name” and the Company believes the actual number of beneficial holders of its Common Stock to be approximately 4,800.

The following table sets forth the high and low sales prices on a quarterly basis for the Company's Common Stock, as reported on Nasdaq, for the two years ended December 31, 2005.

**Common Stock
Sale Prices**

2004	High	Low
First Quarter	\$	