

INNODATA ISOGEN INC
Form 10-Q
May 15, 2007

**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 **March 31, 2007**

OR

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

For the transition period from _____ to

Commission file number: **0-22196**

INNODATA 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) 371-2828

(Registrant's telephone number, including area code)

[None]

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

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

Indicate by check mark whether the registrant 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.

Edgar Filing: INNODATA ISOGEN INC - Form 10-Q

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

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

| | |
|---------------------------|-------------------------------|
| Common Stock | Outstanding at April 30, 2007 |
| \$.01 par value per share | 23,968,341 shares |

INNODATA ISOGEN, INC. AND SUBSIDIARIES
For the Quarter Ended March 31, 2007

Table of Contents

| <u>PART I - FINANCIAL INFORMATION</u> | <u>Page No.</u> |
|---|------------------------|
| ITEM 1 - Financial Statements | 3 |
| ITEM 2 - Management Discussion and Analysis of Financial Conditions and Results of Operations | 15 |
| ITEM 3 - Quantitative and Qualitative Disclosures About Market Risk | 23 |
| ITEM 4 - Controls and Procedures | 23 |
| <u>PART II - OTHER INFORMATION</u> | 25 |
| ITEM 1 - Legal Proceedings | 25 |
| ITEM 1A - Risk Factors | 25 |
| ITEM 2 - Unregistered Sales of Equity Securities and Use of Proceeds | 25 |
| ITEM 3 - Defaults Upon Senior Securities | 25 |
| ITEM 4 - Submission of Matters to a Vote of Security Holders | 25 |
| ITEM 5 - OTHER INFORMATION | 25 |
| ITEM 6 - EXHIBITS | 25 |

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)

| | March 31, 2007 | December 31, 2006 |
|---|---------------------------|--|
| | Unaudited | Derived from audited financial statements |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and equivalents | \$ 12,462 | \$ 13,597 |
| Accounts receivable-net | 7,893 | 6,484 |
| Prepaid expenses and other current assets | 1,657 | 1,589 |
| Refundable income taxes | 1,062 | 1,062 |
| Deferred income taxes | 213 | 190 |
| Total current assets | 23,287 | 22,922 |
| PROPERTY AND EQUIPMENT - NET | 4,562 | 4,564 |
| OTHER ASSETS | 1,849 | 1,912 |
| DEFERRED INCOME TAXES | 256 | 256 |
| GOODWILL | 675 | 675 |
| TOTAL | \$ 30,629 | \$ 30,329 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 1,273 | \$ 987 |
| Accrued expenses | 2,116 | 2,117 |
| Accrued salaries, wages and related benefits | 4,715 | 4,259 |
| Income and other taxes | 1,448 | 1,295 |
| Current portion of long term obligations | 518 | 632 |
| Total current liabilities | 10,070 | 9,290 |
| DEFERRED INCOME TAXES | 1,143 | 1,126 |
| LONG TERM OBLIGATIONS | 1,011 | 904 |
| STOCKHOLDERS' EQUITY: | | |
| Serial preferred stock; 5,000,000 shares authorized, none outstanding | 241 | 241 |

Edgar Filing: INNODATA ISOGEN INC - Form 10-Q

Common stock, \$.01 par value; 75,000,000 shares authorized; 24,090,000 and 24,087,000 issued at March 31, 2007 and December 31, 2006, and 23,908,000 and 23,905,000 outstanding at March 31, 2007 and December 31, 2006

| | | |
|--|------------------|------------------|
| Additional paid-in capital | 17,264 | 17,225 |
| Retained earnings | 1,979 | 2,622 |
| Accumulated other comprehensive income | (760) | (760) |
| | 18,724 | 19,328 |
| Less: treasury stock - at cost; 182,000 shares | (319) | (319) |
| Total stockholders' equity | 18,405 | 19,009 |
| TOTAL | \$ 30,629 | \$ 30,329 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(In thousands, except per share amounts)
(Unaudited)

| | 2007 | 2006 |
|---|-----------|------------|
| REVENUES | \$ 12,729 | \$ 10,285 |
| OPERATING COSTS AND EXPENSES: | | |
| Direct operating expenses | 10,044 | 8,353 |
| Selling and administrative expenses | 3,445 | 3,386 |
| Interest (income) - net | (137) | (151) |
| Total | 13,352 | 11,588 |
| LOSS BEFORE PROVISION FOR INCOME TAXES | (623) | (1,303) |
| PROVISION FOR INCOME TAXES | 20 | 43 |
| NET LOSS | \$ (643) | \$ (1,346) |
| BASIC AND DILUTED LOSS PER SHARE | \$ (.03) | \$ (.06) |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 23,906 | 24,033 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2007 and 2006

(In thousands)

(Unaudited)

| | 2007 | 2006 |
|--|------------------|------------------|
| OPERATING ACTIVITIES: | | |
| Net loss | \$ (643) | \$ (1,346) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 737 | 866 |
| Non-cash compensation | 33 | 58 |
| Deferred income taxes | (6) | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,409) | 1,091 |
| Prepaid expenses and other current assets | (180) | (297) |
| Other assets | 46 | (67) |
| Accounts payable and accrued expenses | 285 | 602 |
| Accrued salaries and wages | 456 | (112) |
| Income and other taxes | 153 | 68 |
| Net cash (used in) provided by operating activities | (528) | 863 |
| INVESTING ACTIVITIES: | | |
| Capital expenditures | (448) | (794) |
| FINANCING ACTIVITIES: | | |
| Payment of long-term obligations | (165) | (179) |
| Proceeds from exercise of stock options | 6 | 356 |
| Net cash (used in) provided by financing activities | (159) | 177 |
| (DECREASE) INCREASE IN CASH AND EQUIVALENTS | (1,135) | 246 |
| CASH AND EQUIVALENTS, BEGINNING OF PERIOD | 13,597 | 20,059 |
| CASH AND EQUIVALENTS, END OF PERIOD | \$ 12,462 | \$ 20,305 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | \$ 1 | \$ 3 |
| Income taxes | \$ 22 | \$ 25 |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | |
| Software licenses and support to be vendor financed | \$ - | \$ 234 |
| Acquisition of equipment utilizing capital leases | \$ 144 | \$ - |

INNODATA ISOGEN, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(In thousands)

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Comprehensive Income | Treasury Stock | Total |
|--|------------------------|------------------------|----------------------------------|----------------------|--|-------------------|-----------|
| January 1, 2007 | 23,905 | \$ 241 | \$ 17,225 | \$ 2,622 | \$ (760) | \$ (319) | \$ 19,009 |
| Net loss | - | - | - | (643) | - | - | (643) |
| Issuance of common stock upon exercise of stock options | 3 | - | 6 | - | - | - | 6 |
| Non-cash equity compensation | - | - | 33 | - | - | - | 33 |
| March 31, 2007 | 23,908 | \$ 241 | \$ 17,264 | \$ 1,979 | \$ (760) | \$ (319) | \$ 18,405 |
| January 1, 2006 | 23,669 | \$ 237 | \$ 16,632 | \$ 9,945 | \$ - | \$ - | \$ 26,814 |
| Net loss | - | - | - | (1,346) | - | - | (1,346) |
| Issuance of common stock upon exercise of stock options | 418 | 4 | 352 | - | - | - | 356 |
| Non-cash equity compensation | - | - | 58 | - | - | - | 58 |
| March 31, 2006 | 24,087 | \$ 241 | \$ 17,042 | \$ 8,599 | \$ - | \$ - | \$ 25,882 |

See notes to condensed consolidated financial statements

INNODATA ISOGEN, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(Unaudited)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business-Innodata Isogen, Inc. and subsidiaries (the "Company"), is a leading provider of business services that help organizations create, manage, use and distribute information more effectively and economically. The Company provides content-related business process outsourcing BPO services and content-related information technology (IT) professional services. The Company's content-related BPO services focus on fabrication services and knowledge services. Fabrication services include digitization and data conversion services, content creation and XML services. Knowledge services include content enhancement, hyperlinking, indexing and general editorial services. The Company's content-related IT professional services focus on the design, implementation, integration and deployment of systems used to author, manage and distribute content.

Basis of Presentation-Consolidated financial statements for the interim periods included herein are unaudited; however, they contain all adjustments (consisting of only normal recurring accruals) which in the opinion of management, are necessary to present fairly the consolidated financial position of the Company as of March 31, 2007, the results of its operations and its cash flows for the three months ended March 31, 2007 and 2006. The results of operations for the interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year.

Principles of Consolidation-The consolidated financial statements include the accounts of Innodata Isogen, Inc. and its subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates-In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include deferred taxes and related valuation allowances, allowances for bad debts and billing adjustments, cash flows used in impairment analysis of long-lived assets, litigation accruals, post retirement benefits, and tax audits.

These financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2006 included in the Company's Annual Report on Form 10-K. Unless otherwise noted, the accounting policies used in preparing these financial statements are the same as those described in the December 31, 2006 financial statements.

Foreign Currency-The functional currency for the Company's production operations located in the Philippines, India and Sri Lanka is U.S. dollars. As such, transactions denominated in Philippine pesos, Indian and Sri Lanka rupees were translated to U.S. dollars at rates which approximate those in effect on transaction dates. Monetary assets and liabilities denominated in foreign currencies at March 31, 2007 and 2006 were translated at the exchange rate in effect as of those dates. Exchange gains and losses resulting from such transactions were not material in three months ended March 31, 2007.

Cash Equivalents-For financial statement purposes (including cash flows), the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

2. LONG TERM OBLIGATIONS

In the first quarter of 2007 the Company entered into capital lease agreements to finance the acquisition of certain computer equipment approximating \$144,000, with repayment terms ranging from 3 to 5 years and bearing interest ranging between 7%-9%.

In the three months ended March 31, 2006, the Company financed the acquisition of software licenses totaling \$164,000. The amount is payable in eight equal quarterly installments through December 31, 2007.

Total long term obligations as of March 31, 2007 and December 31, 2006 consist of the following (amounts in thousands):

| | 2007 | 2006 |
|---|----------|--------|
| Vendor obligations for software licenses | \$ 465 | \$ 609 |
| Capital lease obligations | 159 | 23 |
| Deferred lease payment | 28 | 27 |
| | 652 | 659 |
| Pension obligations - accrued pension liability | 877 | 877 |
| | 1,529 | 1,536 |
| Less: current portion of long term obligations | 518 | 632 |
| Long term obligations | \$ 1,011 | \$ 904 |

3. INCOME TAXES

The Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes" on January 1, 2007. FIN 48 requires companies to determine whether it is "more likely than not" that a tax position will be sustained upon examination by the appropriate taxing authorities before any tax benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, classification and disclosure in the financial statements for uncertain tax positions taken or expected to be taken in a tax return. No cumulative effect of a change in accounting principle or adjustment to the liability for unrecognized tax benefits was recognized as a result of the adoption of FIN 48. Accordingly, the adoption of FIN 48 did not have an effect on the results of operations or financial position of the Company.

The liability for net unrecognized tax benefits at March 31, 2007 and December 31, 2006 was approximately \$565,000. This liability represents an accrual relating to uncertain income tax positions the Company has taken on its domestic and foreign tax returns. Furthermore the Company has unrecognized tax benefits approximating \$167,000 which, if recognized, would increase the Company's net operating loss carryforward. Such increase, if recognized, would not have an impact on the Company's effective tax rate since the increase to its deferred tax assets would result in a corresponding increase to its valuation allowance.

As of March 31, 2007 and December 31, 2006, the Company had accrued a liability for interest and penalties totaling approximately \$138,000.

Pursuant to an income tax audit by the Indian bureau of taxation, on March 27, 2006, one of the Company's Indian subsidiaries has received a tax assessment approximating \$350,000, including interest, for the fiscal tax year ended March 31, 2003. Management disagrees with the basis of the tax assessment, and has filed an appeal against the assessment, which it will fight vigorously. The Indian bureau of taxation has also completed an audit of the Company's Indian subsidiary's income tax return for the fiscal tax year ended March 31, 2004. The ultimate outcome was favorable, and there was no tax assessment imposed for the fiscal tax year ended March 31, 2004. On March 20, 2007, the Company received a notice from the Indian bureau of taxation of their intent to audit its income tax returns for the fiscal year ending 2005. The Company will submit the required documentation allowing them to commence their audit.

The IRS is in the process of auditing the Company's 2004 income tax return, and has indicated that it will review the Company's 2005 tax return.

Various foreign subsidiaries currently have open tax years ranging from 2003 through 2006.

The Company currently cannot estimate the range of the reasonably possible change in unrecognized tax benefits in the next twelve months.

In the three months ended March 31, 2007 and 2006, the provision for income taxes was principally comprised of foreign income taxes attributable to certain overseas subsidiaries which generated taxable income. In addition, the Company did not recognize a tax benefit on U.S. net operating losses generated during these periods because realization of such net operating loss carryforwards is uncertain.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and net operating losses are utilized. Based on a consideration of these factors, the Company has established a valuation allowance of approximately \$4,630,000 and \$4,340,000, at March 31, 2007 and December 31, 2006, respectively.

In addition the Company is subject to various tax audits and claims which arise in the ordinary course of business. Management currently believes that the ultimate outcome of these audits and claims will not have a material adverse effect on the Company's financial position or results of operations.

4. COMMITMENTS AND CONTINGENT LIABILITIES

Line of Credit-The Company has a \$5 million line of credit, which is secured by the Company's accounts receivable, pursuant to which it may borrow up to 80% of eligible accounts receivable at the bank's alternate base rate plus ½% or LIBOR plus 3%. The line, which expires on May 31, 2007, is currently under negotiation for renewal. At March 31, 2007, approximately \$4.4 million was available to borrow under this line based on eligible accounts receivable. The Company has no outstanding obligations under its credit line.

Litigation -In connection with the cessation of all operations at certain foreign subsidiaries, certain former employees have filed various actions against certain of the Company's Philippine subsidiaries, and have purported to also sue the Company and certain of its officers and directors, seeking 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 and benefits of up to approximately \$5.5 million, based upon exchange rates as of March 31, 2007, and consistent with prevailing jurisprudence. Based on consultation with legal counsel, we believe that the complainants' claims are without merit and continue to defend against them vigorously.

In addition, the Company is subject to various legal proceedings and claims which arise in the ordinary course of business.

While management currently believes that the ultimate outcome of all these proceedings will not have a material adverse effect on the Company's financial position or overall trends in results of operations, litigation is subject to inherent uncertainties. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on the operating results of the period in which the ruling occurs. In addition, the estimate of potential impact on the Company's financial position or overall results of operations for the above legal proceedings could change in the future.

5. RESTRUCTURING COST

As part of an overall cost reduction plan to reduce operating costs, in September 2006 the Company announced a worldwide workforce reduction of slightly under 300 employees, the majority of whom were based in Asia. Most of these employees were terminated prior to September 30, and the plan was complete as of March 31, 2007.

As of March 31, 2007 and December 31, 2006, accrued expenses included approximately \$38,000 and \$102,000, respectively, related to restructuring costs charged in 2006. During the three months ended March 31, 2007, the Company paid severance costs totaling \$64,000 and expects to pay the remaining balance of \$38,000 in the second quarter of 2007.

6. STOCK OPTIONS

The following table presents information related to stock options for the three months ended March 31, 2007.

| | Number Outstanding | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
|-----------------|-----------------------|---------------------------------------|-----------------------|---------------------------------------|
| Balance 1/1/07 | 4,548,950 | \$ 2.14 | 4,478,167 | \$ 2.12 |
| Forfeit | - | - | | |
| Expired | (1,750) | \$ 4.00 | | |
| Granted | 60,000 | \$ 2.88 | | |
| Exercised | (2,800) | \$ 2.00 | | |
| Balance 3/31/07 | 4,604,400 | \$ 2.15 | 4,492,553 | \$ 2.12 |

| Per Share Range of Exercise Prices | March 31, 2007 | | | | Options Exercisable | | |
|--|---------------------|---|--|--|-----------------------|--|--|
| | Options Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value as of March 31, 2007 | Number Exercisable | Weighted Average Exercise Price | Aggregate Intrinsic Value as of March 31, 2007 |
| \$0.25 - 0.42 | 130,668 | 1 | \$0.26 | \$ 88,421 | 130,668 | \$0.26 | \$ 88,421 |
| \$0.50 - 0.67 | 1,203,996 | 4 | \$0.57 | 1,578,782 | 1,203,996 | \$0.57 | 1,578,782 |
| \$1.29 | 399,996 | 0 | \$1.29 | 820,432 | 399,996 | \$1.29 | 820,432 |
| \$2.00 | 100,644 | 8 | \$2.00 | 177,133 | 100,644 | \$2.00 | 177,133 |
| \$2.59 - 2.88 | 1,274,346 | 5 | \$2.60 | 912,095 | 1,221,846 | \$2.59 | 912,095 |
| \$3.00 - 3.75 | 1,494,750 | 7 | \$3.44 | -0- | 1,435,403 | \$3.43 | -0- |
| | 4,604,400 | | | \$ 3,576,863 | 4,492,553 | | \$ 3,576,863 |

The fair value of options at date of grant was estimated using the Black-Scholes pricing model with the following weighted average assumptions for options granted in the three months ended March 31, 2007: eight years; risk free

interest rate of 4.56%; expected volatility of 123% and a zero dividend rate. The weighted average grant date fair value of options granted in 2007 was \$2.68. No options were granted during the three months ended March 31, 2006.

The number and weighted-average grant-date fair value of non-vested stock options is as follows:

| | Shares | Weighted Average Grant-Date Fair Value |
|----------------------------|----------|---|
| Non-vested January 1, 2007 | 70,783 | \$ 2.92 |
| Granted 2007 | 52,500 | \$ 2.68 |
| Vested 2007 | (11,436) | \$ 3.03 |
| Non-vested March 31, 2007 | 111,847 | \$ 2.79 |

The total compensation cost related to non-vested stock options not yet recognized as of March 31, 2007 totaled approximately \$275,000. The weighted-average period over which these costs will be recognized is thirty-two months.

The total intrinsic value of options exercised for the three months ended March 31, 2007 and March 31, 2006 was \$3,000 and \$1,130,000 respectively. The total fair value of stock options vested during the three months ended March 31, 2007 was \$35,000.

7. SEGMENT REPORTING AND CONCENTRATIONS

The Company's operations are classified into two reporting segments: (1) content-related BPO services and (2) content-related IT professional services. The content-related BPO services segment focuses on fabrication services and knowledge services. Fabrication services include digitization and data conversion services, content creation and XML services. Knowledge services include content enhancement, hyperlinking, indexing and general editorial services. The content-related IT professional services segment focuses on the design, implementation, integration and deployment of systems used to author, manage and distribute content. The Company's content-related BPO services revenues are generated principally from its production facilities located in the Philippines, India and Sri Lanka. The Company does not depend on revenues from sources internal to the countries in which the Company operates; nevertheless, the Company is subject to certain adverse economic and political risks relating to overseas economies in general, such as inflation, currency fluctuations and regulatory burdens.

**Three Months Ended
March 31,
2007 2006
(in thousands)**

Revenues:

| | | | | |
|--|-----------|---------------|-----------|---------------|
| Content-related BPO services | \$ | 11,549 | \$ | 9,258 |
| Content-related IT Professional services | | 1,180 | | 1,027 |
| Total consolidated | \$ | 12,729 | \$ | 10,285 |

Depreciation and amortization:

| | | | | |
|--|-----------|------------|-----------|------------|
| Content-related BPO services | \$ | 598 | \$ | 747 |
| Content-related IT Professional services | | 29 | | 29 |
| Selling and corporate administration | | 110 | | 90 |
| Total consolidated | \$ | 737 | \$ | 866 |

Loss before income taxes:

| | | | | |
|--|-----------|--------------|-----------|----------------|
| Content-related BPO services | \$ | 2,757 | \$ | 1,651 |
| Content-related IT Professional services | | (237) | | 62 |
| Selling and corporate administration | | (3,143) | | (3,016) |
| Total consolidated | \$ | (623) | \$ | (1,303) |

**March 31, December 31,
2007 2006
(in thousands)**

Total assets:

| | | | | |
|--|-----------|---------------|-----------|---------------|
| Content-related BPO services | \$ | 15,140 | \$ | 13,057 |
| Content-related IT Professional services | | 1,780 | | 2,043 |
| Corporate (includes corporate cash) | | 13,709 | | 15,229 |
| Total consolidated | \$ | 30,629 | \$ | 30,329 |

One client accounted for 18% and 29% of revenues for the three months ended March 31, 2007 and 2006, respectively. A second client accounted for 19% of the Company's revenues for the three months ended March 31, 2007. Two other clients accounted for 13% and 11% of revenues for the similar period in 2006. No other client accounted for 10% or more of the total revenues for these periods. Further, for each of the three months ended March 31, 2007 and 2006, revenues to non-US clients accounted for 25% and 37% respectively, of the Company's revenues.

A significant amount of the Company's revenues is derived from clients in the publishing industry. Accordingly, the Company's accounts receivable generally include significant amounts due from such clients. In addition, as of March 31, 2007, approximately 29% of the Company's accounts receivable was from foreign (principally European) clients and 45% of accounts receivable was due from three clients. As of December 31, 2006, approximately 28% of the Company's accounts receivable was from foreign (principally European) clients and 21% of accounts receivable was due from one client.

8. LOSS PER SHARE

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2007 | 2006 |
| | (in thousands, except per share amounts) | |
| Net loss | \$ (643) | \$ (1,346) |
| Weighted average common shares outstanding | 23,906 | 24,033 |
| Dilutive effect of outstanding options | - | - |
| Adjusted for dilutive computation | 23,906 | 24,033 |
| Basic loss per share | \$ (.03) | \$ (.06) |
| Diluted loss per share | \$ (.03) | \$ (.06) |

Basic income (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted income (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the period increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. The dilutive effect of the outstanding options is reflected in diluted income (loss) per share by application of the treasury stock method. Options to purchase 1.6 million shares of common stock in 2007 and 1.9 million shares of common stock in 2006 were outstanding but not included in the computation of diluted income per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been antidilutive. In addition, diluted net loss per share does not include 3,050,000 and 1,015,000 potential common shares derived from stock options for the three months ended March 31, 2007 and 2006, respectively, because as a result of the Company incurring losses, their effect would have been antidilutive.

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

Disclosures in this Form 10-Q contain certain forward-looking statements, including without limitation, statements concerning our operations, economic performance, and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words “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 indicated from time to time in our filings with the Securities and Exchange Commission.

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

The Company

Innodata Isogen, Inc. and subsidiaries (the “Company”), is a leading provider of business services that help organizations create, manage, use and distribute information more effectively and economically. The Company provides content-related business process outsourcing (BPO) services and content-related information technology (IT) professional services.

The Company’s content-related BPO services focus on fabrication services and knowledge services. Fabrication services include digitization and data conversion services, content creation and XML services. Knowledge services include content enhancement, hyperlinking, indexing and general editorial services.

The Company’s content-related IT professional services focus on the design, implementation, integration and deployment of systems used to author, manage and distribute content.

Services for business processes that we anticipate a client will require for an indefinite period generate what we regard as recurring revenues. Services for a specific project generate revenues that we regard as non-recurring.

We have experienced, and expect to continue to experience, significant fluctuations in our quarterly revenues and results of operations. 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 have at times been unable to avoid declines in revenues when large projects are completed, and we may continue to encounter this difficulty in the future. Our inability in any period to obtain sufficient new projects to counterbalance any decreases in such work adversely affects our revenues and results of operations for the period.

We have historically relied on a very limited number of clients that have accounted for a significant portion of our revenues. We may lose any of these or any of our other major clients as a result of our failure to meet or satisfy our clients' requirements; the completion, termination or reduction of a project or engagement; or the selection of another service provider. Our revenues and results of operations are adversely affected when these events occur.

Our services are typically subject to client requirements, and in many cases are terminable by the client upon 30 to 90 days' notice.

Other factors, some of which are beyond our control, that may also affect our quarterly results include the size, mix, timing and terms and conditions of client projects; variations in the duration, size and scope of our projects or engagements; market acceptance of our clients' new products and services; our ability to manage costs; local factors and events that affect our production volume, such as local holidays; unforeseen events, such as earthquakes, storms and civil unrest; currency exchange fluctuations; changes in pricing policies by us or our competitors; the introduction of new services by us or our competitors; and acquisition and integration costs related to possible acquisitions of other businesses.

Our production facilities are located in the Philippines, India and Sri Lanka. To the extent that the currencies of these countries fluctuate, we are subject to risks of changing costs of production after pricing is established for certain customer projects. However, the majority of our contracts contain provisions for price adjustment.

Direct operating costs for both our content-related BPO services and content-related IT professional services consist of direct payroll, occupancy costs, depreciation, telecommunications, computer services and supplies.

Selling and administrative expenses for both our content-related BPO services and content-related IT professional services consist of management and administrative salaries, selling and marketing costs and administrative overhead.

Results of Operations

Three Months Ended March 31, 2007 and 2006

Revenues

Revenues were \$12.7 million for the three months ended March 31, 2007 compared to \$10.3 million for the similar period in 2006, an increase of 23%.

Revenues from content-related BPO services increased 24% to \$11.5 million for the three months ended March 31, 2007 from \$9.3 million for the similar period in 2006. This increase principally reflects \$1.4 million in revenues from a new project and increased volume of approximately \$800,000 from an ongoing project, both of which are non-recurring.

Revenues from content-related IT professional services increased 20%, to \$1.2 million for the three months ended March 31, 2007, from \$1.0 million for the similar period in 2006. This increase primarily reflects a \$300,000 increase in revenue from a content-related IT professional services project that started late in the fourth quarter of 2006, partly offset by a decrease in revenue of \$200,000 due to the completion in 2006 of a second content-related IT professional services project.

One client accounted for 18% and 29% of our total revenues for the three months ended March 31, 2007 and 2006, respectively. A second client accounted for 19% of our total revenues for the three months ended March 31, 2007. Two other clients accounted for 13% and 11% of our total revenues for the similar period in 2006. No other client accounted for 10% or more of our total revenues for these periods. Further, for the three months ended March 31, 2007 and 2006, revenues from clients located in foreign countries (principally in Europe) accounted for 25% and 37% respectively, of our total revenues.

For the three months ended March 31, 2007, approximately 55% of our revenue was recurring and 45% was non-recurring, compared with 60% and 40%, respectively, for the three months ended March 31, 2006.

Direct Operating Costs

Direct operating costs were \$10.0 million and \$8.4 million for the three months ended March 31, 2007 and 2006, respectively, an increase of 19%. Direct operating costs as a percentage of revenues for the three months ended March 31, 2007 and 2006, were 79% and 81% respectively.

Direct operating costs for content-related BPO services were \$8.6 million and \$7.4 million in the three months ended March 31, 2007 and 2006, respectively, an increase of 16%. Direct operating costs of content-related BPO services as a percentage of revenues from content related BPO services were 75% and 80% for the three months ended March 31, 2007 and 2006, respectively. The increase in direct operating costs of content-related BPO services was principally attributable to increases in variable labor and other operating costs in support of higher revenue volume. The direct operating expenses as a percentage of revenues for our content-related BPO services segment were lower in the three months ended March 31, 2007, compared to the comparable 2006 period, principally due to higher revenues with minimal increases in fixed costs.

Direct operating costs for content-related IT professional services were \$1.4 million and \$1.0 million for the three months ended March 31, 2007 and 2006, respectively, an increase of 40%. Direct operating costs for content-related IT professional services as a percentage of revenues from content-related IT professional services were 117% and 99% for the three months ended March 31, 2007 and 2006, respectively. The increase in direct operating costs of content-related IT professional services was due to increases in labor, recruitment, and other operating costs to support new business that that we anticipate will generate revenues in future quarters.

Selling and Administrative Expenses

Selling and administrative expenses were \$3.4 million for each of the three months ended March 31, 2007 and 2006. Selling and administrative expenses as a percentage of revenues were 27% and 33% for the three months ended March 31, 2007 and 2006, respectively. Additional selling expenses in the three months ended March 31, 2007, which were incurred to support projected revenue growth, were offset by cost reductions, resulting from the restructuring program in September 2006. For the three months ended March 31, 2006, we spent approximately \$300,000 in new services research and development. We did not incur any research and development costs in the three months ended March 31, 2007.

Restructuring Costs

As part of an overall cost reduction plan to reduce operating costs, in September 2006 we announced a worldwide workforce reduction of slightly under 300 employees, the majority of whom were based in Asia. Most of these employees were terminated prior to September 30, and the plan was complete as of March 31, 2007.

During the three months ended March 31, 2007, we paid a total of \$64,000 in severance costs and expect to pay the remaining balance of \$38,000 in the second quarter of 2007.

Provision for Income Taxes

In the three months ended March 31, 2007 and 2006, the provision for income taxes was principally comprised of foreign income taxes attributable to certain overseas subsidiaries which generated taxable income. In addition, we did not recognize a tax benefit on U.S. net operating losses generated during these periods, because realization of such net operating losses is uncertain.

Net Loss / Income

We recorded a net loss of \$643,000 in the three months ended March 31, 2007 compared with a net loss of approximately \$1.3 million in the comparable period in 2006. The decreased net loss was principally attributable to the increase in gross margin resulting from increased revenues.

Liquidity and Capital Resources

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

| | March 31, 2007 | December 31, 2006 |
|---------------------------|-----------------------|------------------------------|
| Cash and Cash Equivalents | \$ 12,462 | \$ 13,597 |
| Working Capital | 13,217 | 13,632 |

Net Cash (Used In) Provided By Operating Activities

Net cash used in operating activities was \$528,000 for the three months ended March 31, 2007 compared to \$863,000 provided by operating activities for the three months ended March 31, 2006, a decrease of approximately \$1.4 million. The \$1.4 million increase in net cash used in operating activities is principally due to a \$2.5 million increase in accounts receivable net of a \$700,000 decrease in net loss and a \$600,000 net change in operation assets and liabilities.

Accounts receivable totaled approximately \$7.9 million at March 31, 2007, representing approximately 51 days of sales outstanding compared to \$6.5 million, or 56 days, at December 31, 2006.

A significant amount of the Company's revenues is derived from clients in the publishing industry. Accordingly, the Company's accounts receivable generally include significant amounts due from such clients. In addition, as of March 31, 2007, approximately 29% of the Company's accounts receivable was from foreign (principally European) clients, and 45% of accounts receivable was due from three clients.

Net Cash Used in Investing Activities

For the three months ended March 31, 2007, we spent cash approximating \$448,000 for capital expenditures, compared to approximately \$794,000 for the three months ended March 31, 2006. Capital spending in 2007 related principally to normal ongoing equipment upgrades and to office improvements. Capital spending in the three months ended March 31, 2006 related principally to normal ongoing equipment upgrades. Furthermore, during the three months ended March 31, 2007, we financed the purchase of equipment approximating \$144,000 through finance leases, and during the three months ended March 31, 2006, we financed the purchase of software licenses totaling approximately \$162,000. During the next twelve months, we anticipate that capital expenditures for ongoing technology, hardware, equipment and infrastructure upgrades will approximate \$3.0 to \$4.0 million.

Net Cash Used In Financing Activities

Proceeds from the exercise of stock options provided cash approximating \$6,000 and \$356,000 for the three months ended March 31, 2007 and 2006, respectively. In addition, payments of long-term obligations approximated \$165,000 and \$179,000 for the three months ended March 31, 2007 and 2006, respectively.

Availability of Funds

We have a \$5.0 million line of credit, which is secured by our accounts receivable, pursuant to which we may borrow up to 80% of eligible accounts receivable at the bank's alternate base rate plus ½% or LIBOR plus 3%. The line, which expires on May 31, 2007, is currently under negotiation for renewal. At March 31, 2007, approximately \$4.4 million was available to borrow under this line based on eligible accounts receivable. We have no outstanding obligations under our credit line.

We believe that existing cash and internally generated funds will be sufficient for our reasonably anticipated working capital and capital expenditure requirements during the next 12 months. We fund our foreign expenditures from our U.S. corporate headquarters on an as-needed basis.

Inflation, Seasonality and Prevailing Economic Conditions

To date, inflation has not had a significant impact on our operations. We generally perform work for our clients under project-specific contracts, requirements-based contracts or long-term contracts. Contracts are typically subject to numerous termination provisions.

Our quarterly operating results are 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 operating results from quarter to quarter.

Critical Accounting Policies and Estimates

Basis of Presentation and Use of Estimates

Management's discussion and analysis of its results of operations and financial condition is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to accounts receivable. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Allowance for Doubtful Accounts

We establish credit terms for new clients based upon management's review of their credit information and project terms, and perform ongoing credit evaluations of our customers, adjusting credit terms when management believes appropriate based upon payment history and an assessment of their current credit worthiness. We record an allowance for doubtful accounts for estimated losses resulting from the inability of our clients to make required payments. We determine this allowance by considering a number of factors, including the length of time trade accounts receivable are past due, our previous loss history, our estimate of the client's current ability to pay its obligation to us, and the condition of the general economy and the industry as a whole. While credit losses have generally been within expectations and the provisions established, we cannot guarantee that credit loss rates in the future will be consistent with those experienced in the past. In addition, we have credit exposure if the financial condition of one of our major clients were to deteriorate. In the event that the financial condition of our clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be necessary.

Revenue Recognition

We recognize revenue for content-related BPO services in the period in which we perform services and deliver in accordance with Staff Accounting Bulletin 104.

We recognize content-related IT professional services revenues from custom application and systems integration development which requires significant production, modification or customization of software in a manner similar to SOP No. 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." We recognize revenue for such services billed under fixed fee arrangements using the percentage-of-completion method under contract accounting as we perform services or reach output milestones. We measure the percentage completed either by the percentage of labor hours incurred to date in relation to estimated total labor hours or in consideration of achievement of certain output milestones, depending on the specific nature of each contract. For arrangements in which percentage-of completion accounting is used, we record cash receipts from customers and billed amounts due from customers in excess of recognized revenue as billings in excess of revenues earned on contracts in progress (which is included in accounts receivable). Revenues from fixed-fee projects accounted for less than 10% of our total revenue for the three months ended March 31, 2007 and 2006 respectively. We recognize revenue billed on a time and materials basis as we perform the services.

Long-lived Assets

We account for long-lived assets under Statement of Financial Accounting Standards ("SFAS") 144, Accounting for the Impairment or Disposal of Long Lived Assets. We assess the recoverability of our long-lived assets, which consist primarily of fixed assets and intangible assets with finite useful lives, whenever events or changes in circumstance indicate that the carrying value may not be recoverable. The following factors, if present, may trigger an impairment review: (i) significant underperformance relative to expected historical or projected future operating results; (ii) significant negative industry or economic trends; (iii) significant decline in our stock price for a sustained period; and (iv) a change in our market capitalization relative to net book value. If the recoverability of these assets is unlikely because of the existence of one or more of the above-mentioned factors, we perform an impairment analysis using a projected discounted cash flow method. We must make assumptions regarding estimated future cash flows and other factors to determine the fair value of these respective assets. If these estimates or related assumptions change in the future, we may be required to record an impairment charge. Impairment charges would be included in general and administrative expenses in our statements of operations, and would result in reduced carrying amounts of the related assets on our balance sheets. We did not recognize impairment in any of our long-lived assets for the three months ended March 31, 2007.

Income Taxes

We determine our deferred taxes based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates, as well as any net operating loss or tax credit carry forwards expected to reduce taxes payable in future years. We provide a valuation allowance when it is more likely than not that some or all of a deferred tax asset will not be realized. We have provided a valuation allowance for net operating loss carry forwards, which may not be realized, and for deferred tax assets in foreign jurisdictions, which may not be realized, because of our current tax holidays. Unremitted earnings of foreign subsidiaries have been included in the consolidated financial statements without giving effect to the United States taxes that may be payable on distribution to the United States to the extent such earnings are not anticipated to be remitted to the United States. In addition we have provided for an accrual for potential tax obligations resulting from income tax audits and other potential tax obligations.

Goodwill and Other Intangible Assets

SFAS 142 requires that we test goodwill for impairment using a two-step fair value based test. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of the impairment loss, if any. If impairment is determined, we will recognize additional charges to operating expenses in the period in which they are identified, which would result in a reduction of operating results and a reduction in the amount of goodwill. Our most recent test for impairment was conducted as of September 30, 2006, in which the estimated fair values of the reporting unit exceeded its carrying amount, including goodwill. As such, no impairment was identified or recorded. Goodwill is subject to at least an annual assessment for impairment and more frequently if circumstances indicate a possible impairment.

Accounting for Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123(R) ("SFAS 123(R)"), "Share-Based Payments," which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123(R) supersedes our previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." Under the intrinsic value method, no share-based compensation expense had been recognized at the time stock option awards were granted, because the awards had an exercise price equal to or greater than the market value of our stock on the date of the grant. However, at times, compensation expense had been recognized upon the modifications of stock option grants.

Legal Proceedings

We are involved in numerous legal proceedings and claims. Our legal reserves related to these proceedings and claims are based on a determination of whether or not the loss is either probable or reasonably possible. We review outstanding claims and proceedings with external counsel to assess probability and estimates of loss. The reserves are adjusted if necessary. If circumstances change, we may be required to record adjustments that could be material to its reported financial condition and results of operation.

Development Costs of Software

We expense as research and development costs for the development of new software to be sold, leased, or otherwise marketed as a separate product or as part of a product or process, and substantial enhancements to such existing software products, until technological feasibility has been established, at which time any additional development costs are capitalized until the product is available for general release to customers. We expense all other research and development costs as incurred.

We did not capitalize any software development costs during the three months ended March 31, 2007 and 2006. Included in the selling and administrative expense are research and development costs totaling approximately \$300,000 for the three months ended March 31, 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to interest rate change market risk with respect to our credit line with a financial institution which is priced based on the bank's alternate base rate (8.25% at March 31, 2007) plus ½% or LIBOR (5.375%) plus 3%. We have no outstanding obligations under our credit line. To the extent we utilize all or a portion of this line of credit, changes in the interest rate will have a positive or negative effect on our interest expense.

We have operations in foreign countries. While we are exposed to foreign currency fluctuations, we presently have no financial instruments in foreign currency and do not maintain significant funds in foreign currency beyond those necessary for operations.

Item 4. Controls and Procedures

An evaluation has been carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and the operation of our "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) as of March 31, 2007 ("Evaluation Date"). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the disclosure controls and procedures are reasonably designed and effective to ensure that (i) information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) 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.

There were no changes in our internal controls over financial reporting in connection with the evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 under the Exchange Act that occurred during our last fiscal quarter that materially affected or are reasonably likely to materially affect the internal controls over financial reporting.

PART II. OTHER INFORMATION

Items 1, 1A, 2, 3, 4 and 5 are not applicable and have been omitted.

Item 6. (a) Exhibits.

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

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

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

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

SIGNATURES

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

INNODATA ISOGEN, INC.

Date: May 15, 2007

/s/ Jack Abuhoff

Jack Abuhoff
Chairman of the Board of Directors,
Chief Executive Officer and President

Date: May 15, 2007

/s/ Steven L. Ford

Steven L. Ford
Executive Vice President,
Chief Financial Officer
and Principal Accounting Officer