INNODATA ISOGEN INC
Form 10-K
February 28, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

þ Annual report under section 13 or 15(d) of the securities exchange act of 1934
For the fiscal year ended December 31, 2011

o 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	13-3475943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Three University Plaza Hackensack, New Jersey	07601
(Address of principal executive offices)	(Zip Code)

(201) 371-8000
(Registrant's telephone number)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock $.01 par value	The Nasdaq Stock Market, LLC

Securities registered under Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No þ

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 o No þ

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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. þ

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 o Accelerated filer þ Non-accelerated filer o Smaller reporting company o

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

Yes o No þ

The aggregate market value of the registrant’s common stock held by non-affiliates of the registrant (based on the closing price reported on the Nasdaq Stock Market on June 30, 2011) was $58,474,000.

The number of outstanding shares of the registrant’s common stock, $.01 par value, as of January 31, 2012 was 24,691,224.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for the 2012 Annual Meeting of Stockholders are incorporated by reference in Items 10,11,12,13 and 14 of Part III of this Form 10-K.

INNODATA ISOGEN, INC.

Form 10-K

For the Year Ended December 31, 2011

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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, *Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words "estimate," "believe," "expect," "anticipate," "intend" and other similar expressions generally identify forward-looking statements, which speak only as of their dates.*

These forward-looking statements are based largely on our current expectations, and are subject to a number of risks and uncertainties, including without limitation, that our IADS segment has not reported any revenues to date and is subject to the risks and uncertainties of early-stage companies; the primarily at-will nature of the contracts between our Content Services segment and its clients and the ability of clients to reduce, delay or cancel projects; continuing Content Services revenue concentration in a limited number of clients; continuing Content Services reliance on project-based work; inability to replace projects that are completed, cancelled or reduced; depressed market conditions; changes in external market factors; the ability and willingness of our clients and prospective clients to execute business plans which give rise to requirements for digital content and professional services in knowledge processing; difficulty in integrating and deriving synergies from acquisitions, joint venture and strategic investments; 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 Form 10-K 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. Business.

Business Overview

Innodata (NASDAQ: INOD) is a leading provider of business process, technology and consulting services, as well as products and solutions, that help our valued clients create, manage, use and distribute digital information. Propelled by a culture that emphasizes quality, service and innovation, we have developed a client base that includes many of the world's preeminent media, publishing and information services companies, as well as leading enterprises in information-intensive industries such as aerospace, defense, financial services, government, healthcare, high technology, insurance, intelligence, manufacturing and law.

We operate in two reporting segments.

Our Content Services (CS) segment provides services that support the creation, enhancement, and re-purposing of digital content. These services include high-accuracy conversion to digital text; data analysis and enhancement of legal, financial, medical and technical information; information technology services related to digital content management and products; and consulting services to help clients with strategic and tactical aspects of digital content operations.

Our clients include legal and business information providers; scientific, technical and medical publishers; providers of mobile computing devices and digital content distribution platforms; enterprises that create and manage large volumes of product support content; and governmental agencies that manage large volumes of content in support of mission.

Most of our business information and publishing clients are in the process of transforming from print publishing to online publishing; from online publishing to multiple-channel distribution that includes web as well as mobile, tablet and eReading devices; or from search-based information products to workflow-based information products. These transformations require the adoption of new strategies, technologies and processes. We help our clients set digital content production and product strategies; integrate new technologies and processes; improve the quality and efficiency of content creation, enrichment and transformation; publish through multiple channels (including portable devices); and build new digital products.

Our clients who market mobile computing devices and digital content distribution platforms are seeking to expand the breadth and depth of their digital inventories. We are one of the largest producers of eBooks, serving the leading manufacturers of eBook reading devices as well as trade, education and professional publishers that sell eBooks. We presently distribute eBooks to more than 20 eBook distributors across North America, the United Kingdom, Australia and 24 countries in the European Union. We manufacture standard eBooks in multiple formats, as well as dual and multi-lingual eBooks and enhanced and interactive eBooks.

Many of our enterprise and government clients are embracing new digital information technologies and workflow processes within their operations in order to improve the efficiency of producing product support content, to broaden channels of distribution for such content to web and tablet platforms, and to make such information more easily searched and discovered. Other enterprise and government clients are embarking on this migration in order to improve internal situational decision-support systems (for example, an insurance company seeking to support its distributed field personnel with searchable procedure manuals on the iPad®). We assist our enterprise clients to accomplish these goals by providing technology, process redesign, and content enrichment services.

In the second quarter of 2011, we launched Innodata Advanced Data Solutions (IADS) as a separate segment to perform advanced data analysis. IADS operates through two divisions. The Synodex division of IADS offers a range of document and data analysis services that are tailored to healthcare, medical and insurance companies. The docGenix division of IADS provides financial services institutions with software products and services that facilitate the analysis and management of legal documentation relating primarily to derivatives. We presently own 77% of the Synodex division and 78% of the docGenix division, both limited liability companies. We purchased certain assets of the docGenix division from a third party for $0.4 million. These divisions are at an early stage of development and reported no revenues in 2011.

Each of our segments is organized and managed around three vectors: a vertical industry focus, a horizontal service/process focus, and a supportive operations focus.

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

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

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

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

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

Our Opportunity

Rapid changes in digital content technologies have created the need for all sorts of companies to refashion their product offerings and their operations. Media, publishing and information services companies contend with new monetization models, delivery platforms, and channels. They seek to develop new digital products as print product revenue wanes; to broaden their markets by distributing content over the iPad®, iPhone® and other portable devices; and to monetize existing content in new, highly-targeted custom products through flexible reuse and repurposing.

Meanwhile, for enterprises that rely on content to support other products or operations, this shift to digital technology enables product support information to be produced with greater operational efficiency across a greater variety of channels and languages. This shift also offers opportunities to improve internal decision support and risk mitigation in complex data operations by harnessing the power of machine-readable, digital data to drive improved decision-support.

As a result, media, publishing and information services companies, and content-intensive enterprises, are increasingly relying on service providers such as Innodata to provide digital content-related services.

Our Services

We provide an array of services to help companies both define and implement strategies related to digital data. Both our Content Services segment and our IADS segment provide (i) digitization, enhancement and analysis services; (ii) technology services; and (iii) consulting services.

Digitization, Enhancement and Analysis Services – We provide high-accuracy, large-scale digitization services to transform content from paper and image formats into digital text, and we provide enhancement and analysis services to configure digital text into high-value information products and knowledge repositories that are enriched, structured, normalized, and referenced. We provide these services using a globally distributed workforce utilizing advanced technologies which automate portions of our process and help ensure that our work product is highly accurate and consistent. For our enhancement and analysis services, we maintain a staff in a wide spectrum of disciplines, including medicine, law, engineering, management, finance, science and the humanities.

For example, a publishing company—recently created by a group of publishing industry veterans—emphasizing social media connections between authors and readers engaged Innodata to provide digitization services that support multimedia technologies and multiple platforms. Innodata provided the necessary content production services to publish works to a variety of electronic devices, enabling the company to rapidly develop new digital products without direct investment in staff, facilities or technology.

For a leading electronics manufacturer that merchandises eBooks on its proprietary eReader platform, Innodata transforms digital files used for print productions into eBook files.

A leading provider of networking equipment engages Innodata to provide digital enhancement and related production systems support for its product guides, release notes, configurations guides, installation guides and other documents.

Technology Services – We provide systems integration services in respect of many leading content management systems and enterprise database technologies, as well as custom application development and maintenance for information products, editorial and production systems, data feed integration, portals, websites and mobile applications. We help our customers migrate from print-centric processes to media-neutral content delivery.

For example, we helped develop a custom mobile application for a $13 billion global publisher, that enabled the publisher to distribute its web-based content to the iPad® as well as Android and Windows-enabled mobile devices, while providing support for links to external sources, subscriber annotations, and a host of other functions not yet available on leading eReader applications.

For a €3 billion global information company, our technology team developed a web and tablet-based digital workflow product based on an existing print product.

We have a special focus on XML and related structured information standards, and a number of our engineering staff have played leadership roles in the development of such standards. We use a hybrid onshore/offshore development approach that provides both the benefits of onsite project management, onshore solutions architecture and offshore globally distributed teams of developers. We embrace agile development methodologies that provide the benefits of early solution visualization and an iterative development process.

Consulting Services – Our consulting practice works with clients at a strategic business and technology level to address challenges and business processes related to digital content supply chain optimization, content technology architecture and strategy, global sourcing, digital product strategy and development, and the deployment of content technologies that relate to areas of strategic focus like mobility, social platform and semantic search.

For example, for a multinational information services company, our consulting practice plays a leading role in a long-term, transformative program of work. Our consultants work in conjunction with the client’s internal teams, engaged in designing new content architectures and implementing new content technologies as it reengineers from product-centric to content-centric business processes.

Integrated Services – Many of our client engagements draw upon a combination of Digitization, Enhancement and Analysis Services, Technology Services and Consulting Services. For example, a large, international publisher is in the process of a print-to-digital migration for many of its key products. Among these is a long-standing loose-leaf product for securities lawyers which the client sought to reinvent as a digital workflow product. Innodata provided a combination of content enrichment, user interaction design, and custom application development required to meet a six month launch plan. We now provide on-going technology and content maintenance services in respect of the product.

Clients

Three clients each generated more than 10% of our revenues in the fiscal year ended 2011. Revenues from Apple Inc. ("Apple") were approximately $13.3 million, or 18% of total revenues; revenues from Wolters Kluwer affiliated companies (the "WK Clients") were approximately $10 million or 14% of total revenues; and revenues from Reed Elsevier affiliated companies (the "RE Clients") were approximately $9.3 million or 13% of total revenues. No other client generated more than 10% of our revenues in 2011. These three clients together generated approximately 44%, 27% and 16% of our total revenues in the fiscal years ended December 31, 2011, 2010 and 2009, respectively. Revenues from clients located in foreign countries (principally in Europe) accounted for 30%, 33% and 21% of our total revenues for each of these respective fiscal years.

We have long-standing relationships with many of our clients, and have provided services to two of the three clients mentioned in the preceding paragraph for over ten years. Many of our clients are recurring clients, meaning that they have continued to provide additional projects to us after their initial engagement. Our track record of delivering high-quality services helps us to solidify client relationships and gain increased business from our existing clients. As a result, our history of client retention enables us to derive a significant proportion of revenue from repeat clients.

Our contractual arrangements with Apple during calendar year 2011 consisted of a master services agreement (“MSA”) and a statement of work (“SOW”). The MSA and SOW automatically renew on a monthly basis unless terminated by either party for convenience on 60 days’ prior notice. The MSA may be terminated by either Apple or the Company for material breach, failure to meet service levels, or insolvency related events that that are not cured during a 30-day notice period, or if the material breach is incapable of cure, immediately on written notice. Apple may also terminate the MSA in the event of a force majeure that materially affects performance and lasts for more than 30 days. The SOW may be terminated by either party for “cause” on 30 days’ notice (0 days’ notice if the “cause” is incurable), and without “cause” on 60 days’ notice. The MSA also contains confidentiality, indemnification and other standard provisions.

Our contractual arrangements with the WK Clients during calendar year 2011 consisted of multiple MSAs and separately agreed to SOWs for specific services. Three MSAs have indefinite terms, two MSAs continue in effect until the later of their expiration date and the completion of all services performed pursuant to such MSA, and three MSAs have terms that expire, respectively, in December 2012, July 2013 and March 2017. WK Clients may terminate certain MSAs on notice periods ranging from three months to 30 days, and they may terminate certain individual SOWs on notice periods ranging from 10 days to three months. WK Clients may also terminate certain of the MSAs and SOWs on notice periods of 60 days or less for “cause” and for insolvency related events, and on changes of control, force majeure and the imposition of certain price increases by the Company that are not acceptable to them. The Company may terminate certain of the MSAs on notice periods of three months, and it may also terminate certain MSAs and SOWs for “cause”, insolvency related events affecting the WK Clients, and other defined events. The MSAs contain confidentiality, limitation of liability, indemnification and other standard provisions.

Our contractual arrangements with the RE Clients during 2011 consisted of multiple MSAs and separately agreed to SOWs for specific services. Two of the MSAs have indefinite terms, a third has a term that ends in February 2014, and the fourth has a term that ends on the later of September 2015 or the expiration date of all SOWs issued under that MSA. RE Clients may terminate the MSAs on notice periods ranging from zero to six months, and they may terminate their SOWs on notice periods of up to 180 days. They may also terminate certain of the MSAs and SOWs on notice periods of three months or less for “cause” and for insolvency related events, and on changes of control, force majeure and the imposition of certain price increases by the Company that are not acceptable to them. The Company may terminate two of the MSAs on notice periods of 180 days, and a third on a notice period of three months, and it may also terminate certain MSAs and SOWs for “cause”, insolvency related events affecting the RE Clients, and other defined events. The MSAs contain confidentiality, limitation of liability, indemnification and other standard provisions.

Our agreements with our other clients are in many cases terminable on 30 to 90 days' notice. A substantial portion of the services we provide to our clients is subject solely to their requirements.

Competitive Strengths

Our expertise in digital data. We are primarily focused on helping clients across multiple vertical industries use digital data to build new kinds of products, to reduce publishing cost and to improve decision support.

Our focus on quality. We have achieved a reputation within our clients for consistently delivering high-quality content. We maintain independent quality assurance capabilities in all geographies where we operate. Our quality teams are compliant and certified to the ISO 9000:2000 quality management system standards.

Our global delivery model. We have operations in seven countries in North America, Europe and Asia. We provide services to our clients through a comprehensive global delivery model that integrates both local and global resources to obtain the best economic results. Our offshore outsourcing centers are ISO 9001:2000 certified and our engineering and IT facility meets ISO/IEC 27001:2005 specifications.

Our proven track record and reputation. By consistently providing high-quality services, we have achieved a track record of project successes. This track record is embodied by our reputation as a leader in the business process services, especially within the media, publishing and information services sector. This reputation or brand provides an assurance of expertise, quality execution and risk mitigation.

Our focus on technology and engineering. Rather than simply relying on labor cost arbitrage to create value for clients, our engineering and IT team optimizes efficiency by integrating proprietary and best-in-class third party tools into our workflows. In addition, our engineering and IT team provides work directly to our clients, helping them achieve improved efficiencies within their own operations.

Our long-term relationships with clients. We have long-term relationships with many of our clients, who frequently retain us for additional projects after a successful initial engagement. We believe there are significant opportunities for additional growth with our existing clients, and we seek to expand these relationships by increasing the depth and breadth of the services we provide. This strategy allows us to use our in-depth client-specific knowledge to provide more fully integrated services and develop closer relationships with those clients.

Our ability to scale. We have demonstrated the ability to expand our teams and facilities to meet the needs of our clients. By virtue of the significant numbers of professional staff working on projects, we are able to build teams for new engagements quickly. We have also demonstrated the ability to hire and train people quickly.

Our internal infrastructure. We utilize established facilities, technology and communications infrastructure to support our business model. We own and operate some of the most advanced content production facilities in the world, which are linked by multi-redundant data connections. Our wide area network – along with our local area networks, storage area networks and data centers – is configured with full redundancy, often with more than one backup to ensure 24x7 availability. Our infrastructure is built to accommodate advanced tools, processes and technologies that support our content and technical experts.

Sales and Marketing

We market and sell our services directly through our professional staff, senior management and direct sales personnel operating out of our corporate headquarters in Hackensack, New Jersey, just outside New York City and our Dallas, Texas office. We have five executive-level business development and marketing professionals, and during 2011, we maintained approximately 20 full-time sales and marketing personnel. We also deploy solutions architects, technical support experts and consultants who support the development of new clients and new client engagements. These resources work within teams (both permanent and ad hoc) that provide support to clients.

Our sales professionals identify and qualify prospects, securing direct personal access to decision makers at existing and prospective clients. They facilitate interactions between client personnel and our service teams to better define ways in which we can assist clients with their goals. For each prospective client engagement, we assemble a team of our senior employees drawn from various disciplines within our Company. The team members assume assigned roles in a formalized process, using their combined knowledge and experience to understand the client's goals and collaborate with the client on a solution.

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

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 client service group support our direct sales effort by providing ongoing project-level support to our clients.

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, generating qualified, early-stage leads and furnishing effective sales support tools.

As part of our marketing strategy we partner with media organizations within publishing and non-publishing (enterprise) industries in order to build awareness, establish a reputation as an industry thought leader and generate leads. Media partners include trade associations and publications, trade show producers and consulting organizations. These partnerships are particularly valuable in enterprise industries as we build our presence among digital content leaders and decision makers.

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 integrated marketing campaigns, search engine optimization, search engine marketing and the maintenance and continued development of external websites).

Research and Development

We did not incur any research and development costs in any of the three years ended December 31, 2011.

Competition

The market for publishing services and related services is highly competitive, fragmented and intense. Our major competitors include Apex CoVantage, Aptara, Cenveo, Infosys, HCL Technologies, Macmillan India, SPI

Technologies, JSI S.A.S. Groupe Jouve' and Thomson Digital.

We compete successfully by offering high-quality services and favorable pricing that leverages 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, require “high-end” talent, are sizable in scope or scale, are continuing, or that require a highly fail-safe environment with technology redundancy.

As a provider of these services, we also compete with in-house personnel at existing or prospective clients who may attempt to duplicate our services in-house.

Locations

We are headquartered in Hackensack, New Jersey, just outside New York City. We have an additional office in Dallas, Texas. We have nine production facilities in the Philippines, India, Sri Lanka and Israel. In the fourth quarter of 2011, we commissioned new state-of-the art delivery centers in Noida, India and Sri Lanka. In the first quarter of 2012, we will be further expanding our facilities to accommodate anticipated growth in our business.

Employees

As of December 31, 2011, we employed approximately 65 persons in the United States and Europe and over 7,000 persons in ten production facilities in the Philippines, India, Sri Lanka and Israel. 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.

Corporate Information

Our principal executive offices are located at Three University Plaza, Hackensack, New Jersey 07601, and our telephone number is (201) 371-8000. Our website is www.innodata-isogen.com, and information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. There we make available, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with, or furnish it to, the Securities and Exchange Commission (SEC). Our SEC reports can be obtained through the Investor Relations section of our website or from the Securities and Exchange Commission at www.sec.gov.

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 were to 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. Our top three clients generated 44%, 28% and 16% of our revenues in the fiscal years ended December 31, 2011, 2010 and 2009, respectively. Another client accounted for less than 10% of our revenues for the year ended December 31, 2011, but for 11% and 35% of our revenues for the years ended December 31, 2010 and 2009, 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 client's selection of another service provider.

In addition, the volume of work performed for our major clients may vary from year to year, and services they require from us may change from year to year. If the volume of work performed for our major clients varies or if the services they require from us change, 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 many 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 or otherwise terminated 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. While we seek, wherever possible, on completion or termination of large projects, to counterbalance periodic declines in revenues with new arrangements to provide services to the same client or others, our inability to obtain sufficient new projects to counterbalance any decreases in such work may adversely affect our future revenues and results of operations.

The docGenix and Synodex subsidiaries in our IADS segment are early stage companies.

We have invested significant amounts in these subsidiaries and intend to invest additional amounts. These subsidiaries generated no revenues in 2011, and are subject to the risks and uncertainties of early stage companies. There can be no assurance that these subsidiaries will be viable.

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.

Several significant clients account for a large percentage of our accounts receivable. If any of these clients were unable, or refused, for any reason, to pay our accounts receivable, our financial condition and results of operations would be adversely affected. As of December 31, 2011, 62% or $13.4 million, of our accounts receivable was due from two clients. There was a significant increase in our accounts receivable as of December 31, 2011 as compared to the prior year primarily on account of one large client from whom we experienced a process delay in payments to us against our invoices. See “Liquidity and Capital Resources.”

In addition, we evaluate the financial condition of our clients and usually bill and collect on relatively short cycles. We maintain specific allowances against doubtful receivables. Actual losses on client balances could differ from those that we currently anticipate and, as a result, we might need to adjust our allowances. There is no guarantee that we will accurately assess the creditworthiness of our clients. Macroeconomic conditions, such as the continued credit crisis and related turmoil in the global financial system, could also result in financial difficulties, including limited access to the credit markets, insolvency or bankruptcy, for our clients, and, as a result, could cause clients to delay payments to us, request modifications to their payment arrangements that could increase our receivables balance, or default on their payment obligations to us. If we are unable to collect timely from our clients, our cash flows could be adversely affected.

Quarterly fluctuations in our revenues and 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 (loss) ranged from a loss of approximately $1.4 million in the first quarter of 2010 to a profit of approximately $2.3 million in the fourth quarter of 2011.

We experience fluctuations in our revenue and earnings as we replace and begin new projects, which may have some normal start-up delays, or we may be unable to replace a project entirely. These and other factors may contribute to fluctuations in our results of operations from quarter to quarter.

A high percentage of our operating expenses, particularly personnel and rent, are relatively fixed in advance of any particular quarter. As a result, unanticipated variations in the number and timing of our projects, or in employee wage levels and utilization rates, may cause us to significantly underutilize our production capacity and employees, resulting in significant variations in our operating results in any particular quarter, and have resulted in losses.

The economic environment and pricing pressures could negatively impact our revenues and operating results.

Due to the intense competition involved in outsourcing and information technology services, we generally face pricing pressures from our clients. Our ability to maintain or increase pricing is restricted as clients generally expect to receive volume discounts or special pricing incentives as we do more business with them; moreover, our large clients may exercise pressure for discounts outside of agreed terms.

In addition, a significant portion of our revenues was derived from clients located in the U.S. and Europe. If the U.S. or European economy continues to weaken or slow, pricing for our services may be depressed, which may adversely impact our revenues and profitability.

Our profitability could suffer if we are not able to maintain pricing on our existing projects and win new projects at appropriate margins.

Our profit margin, and therefore our profitability, is dependent on the rates we are able to recover for our services. If we are not able to maintain pricing on our existing services and win new projects at profitable margins, our profitability could suffer. The rates we are able to recover for our services are affected by a number of factors, including competition, the value our client derives from our services and general economic and political conditions.

If our pricing structures do not accurately anticipate the cost and complexity of performing our work, then our contracts could be unprofitable.

We provide services either on a time-and-materials basis or on a fixed-price basis. Our pricing is highly dependent on our internal forecasts and predictions about our projects, which might be based on limited data and could turn out to be inaccurate. If we do not accurately estimate the costs and timing for completing projects, our contracts could prove unprofitable for us or yield lower profit margins than anticipated.

Our inability to obtain price increases and improve our efficiency may impact our results of operations.

In the past few years, we have experienced wage inflation in the Asian countries where we have the majority of our operations. In addition, we are recently experiencing adverse fluctuations in foreign currency exchange rates. These global events have put pressure on our profitability and our margins. Although we have tried to partially offset wage increases and foreign currency fluctuations through price increases and improving our efficiency, we cannot ensure that we may be able to continue to do so in the future, which would negatively impact our results of operations.

If our clients are not satisfied with our services, they may terminate our contracts with them or our services, which could have an adverse impact on our business.

Our business model depends in large part on our ability to attract additional work from our base of existing clients. Our business model also depends on relationships our account teams develop with our clients so that we can understand our clients' needs and deliver solutions and services that are tailored to those needs. If a client is not satisfied with the quality of work performed by us, or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the client's dissatisfaction with our services could damage our ability to obtain additional work from that client. In particular, clients that are not satisfied might seek to terminate existing contracts, which would mean that we could incur costs for the services performed with no associated revenue upon termination of a contract. This could also direct future business to our competitors. In addition, negative publicity related to our client services or relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new contracts with current and prospective clients.

Our new clients may not generate the level of revenues anticipated for reasons beyond our control.

As we get new opportunities and win new business, our new clients may not generate the level of revenues that we initially anticipated at the time of signing an agreement with them. This could be due to various reasons beyond our control. We may invest in people or technology and incur other costs in anticipation of revenues, and as such any deviation from our expected plan would impact our margins and earnings.

Our business will suffer if we fail to develop new services and enhance our existing services in order to keep pace with the rapidly evolving technological environment or provide new service offerings, which may not succeed.

The outsourcing, information technology and consulting services industries are characterized by rapid technological change, evolving industry standards, changing client preferences and new product and service introductions. Our future success will depend on our ability to develop solutions that keep pace with changes in the markets in which we provide services. We cannot guarantee that we will be successful in developing new services, addressing evolving technologies on a timely or cost-effective basis or, if these services are developed, that we will be successful in the marketplace. In addition, we cannot guarantee that products, services or technologies developed by others will not render our services non-competitive or obsolete. Our failure to address these developments could have a material adverse effect on our business, results of operations and financial condition.

We invest in developing and pursuing new service offerings from time to time. Our profitability could be reduced if these services do not yield the profit margins we expect, or if the new service offerings do not generate the planned revenues.

We have made and continue to make significant investments towards building-out new capabilities to pursue growth. These investments increase our costs and if these services do not yield the revenues or profit margins we expect and we are unable to grow our business and revenues proportionately, our profitability may be reduced.

We depend on third-party technology in the provision of our services.

We rely upon certain software that we license from third parties, including software integrated with our internally developed software used in the provision of our services. These third-party software licenses may not continue to be available to us on commercially reasonable or competitive terms, if at all. The loss of, or inability to maintain or obtain any of these software licenses, could result in delays in the provision of our services until we develop, identify, license and integrate equivalent software. Any delay in the provision of our services could damage our business and adversely affect our results of operations.

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

The markets for our services are highly competitive and fragmented. We compete successfully against our competitors; however, 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 their own personnel. We cannot guarantee 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 may fail to attract and retain enough sufficiently trained employees to support our operations, as competition for highly skilled personnel is significant. These factors could have a material adverse effect on our business, results of operations, financial condition and cash flows.

The outsourcing industry relies on large numbers of skilled employees, and our success depends to a significant extent on our ability to attract, hire, train and retain qualified employees. The outsourcing industry, including our Company, experiences high employee attrition. Increased competition for these professionals, in the outsourcing industry or otherwise, could have an adverse effect on us. A significant increase in the attrition rate among employees with specialized skills could decrease our operating efficiency and productivity.

In addition, our ability to maintain and renew existing engagements and obtain new businesses will depend, in large part, on our ability to attract, train and retain personnel with skills that enable us to keep pace with growing demands for outsourcing, evolving industry standards and changing client preferences. Our failure to attract, train and retain personnel with the qualifications necessary to fulfill the needs of our existing and future clients or to assimilate new employees successfully could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Disruptions in telecommunications, system failures, data corruption or virus attacks could harm our ability to execute our global resource model, which could result in client dissatisfaction and a reduction of our revenues.

We use a distributed global resource model. Our onshore workforce provides services from our North American and European offices, as well as from client sites; and our offshore workforce provides services from our ten overseas production facilities in the Philippines, India, Sri Lanka and Israel. All our global facilities are linked with a telecommunications network that uses multiple service providers. We may not be able to maintain active voice and data communications between our various facilities and our clients' sites at all times due to disruptions in these networks, system failures, data corruption or virus attacks. Any significant failure in our ability to communicate could result in a disruption in business, which could hinder our performance or our ability to complete client projects on time. This, in turn, could lead to client dissatisfaction and an adverse effect on our business, results of operations and financial condition.

Governmental and customer focus on data security could increase our costs of operations. In addition, any incidents in which we fail to protect our clients' information against security breaches could result in monetary damages against us, including termination of engagement by our client, and may adversely impact our results of operations.

Certain laws and regulations regarding data privacy and security affecting our clients impose requirements regarding the privacy and security of information maintained by these clients, as well as notification to persons whose personal information is accessed by an unauthorized third party. As a result of any continuing legislative initiatives and client demands, we may have to modify our operations with the goal of further improving data security. Any such modifications may result in increased expenses and operating complexity, and we may be unable to increase the rates we charge for our services sufficiently to offset these increases. In addition, we may be bound by certain client agreements to use and disclose the confidential client information in a manner consistent with the privacy standards under regulations applicable to such client. If client confidential information is inappropriately disclosed due to a breach of our computer systems, system failures or otherwise, we may have substantial liabilities to our clients or our clients' customers. Any breach or alleged breach of our confidentiality agreements with our clients may result in termination of their engagements, resulting in associated loss of revenue and increased costs.

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, Sri Lanka and Israel, 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 significant 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, Sri Lanka and Israel, is incurred in the local currencies of the 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 and India have at times experienced high rates of inflation as well as major fluctuations in the exchange rate between the Philippine peso and the U.S. dollar and the Indian rupee and the U.S. dollar. Continuing inflation without corresponding devaluations of the peso and rupee against the dollar, or any other increase in the value of the peso or rupee relative to the dollar, could adversely affect our results of operations.

There is no guarantee that our financial results will not be adversely affected by currency exchange rate fluctuations or that any efforts by us to engage in foreign currency hedging activities will be effective. Finally, as most of our expenses are incurred in currencies other than those in which we bill for the related services, any increase in the value of certain foreign currencies against the U.S. dollar could increase our operating costs.

In the event that the government of India, the Philippines or the government of another country changes its tax policies, rules and regulations, our tax expense may increase and affect our effective tax rates.

We are subject to income taxes in both the U.S. and numerous foreign jurisdictions. We are subject to the continual examination by tax authorities in India, and the Company assesses the likelihood of outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. Although we believe our tax estimates are reasonable, the final determination of tax audits could be materially different from what is reflected in historical income tax provisions and accruals, and could result in a material effect on the Company's income tax provision, net income or cash flows in the period or periods for which that determination is made. If additional taxes are assessed, it could have an adverse impact on our financial results.

In addition, unanticipated changes in the tax rates, tax laws or the interpretation of tax laws in the jurisdiction where we operate, could affect our future results of operations.

Our operating results may be adversely affected by our use of derivative financial instruments.

We have entered into a series of foreign currency forward contracts that are designated as cash flow hedges. These contracts are intended to partially offset the impact of the movement of the exchange rates on future operating costs of our Asian subsidiaries. The hedging strategies that we have implemented or may implement to mitigate foreign currency exchange rate risks may not reduce or completely offset our exposure to foreign exchange rate fluctuations and may expose our business