

INNODATA INC
Form 10-Q
November 08, 2016

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

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from _____ to _____

Commission file number: **0-22196**

INNODATA INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 13-3475943 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|--|--------------|
| Three University Plaza | 07601 |
| Hackensack, New Jersey | (Zip Code) |
| (Address of principal executive offices) | |

(201) 371-8000

(Registrant's telephone number, including area code)

[None]

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

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

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

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

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

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

Yes ☐ No ☒

The number of outstanding shares of the registrant’s common stock, \$.01 par value, as of October 28, 2016 was 25,623,832.

INNODATA INC. AND SUBSIDIARIES

For the Quarter Ended September 30, 2016

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INNODATA INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(in thousands, except share and per share amounts)**

| | September 30, 2016 | December 31, 2015 |
|---|--------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,277 | \$ 24,908 |
| Accounts receivable, net | 9,695 | 9,249 |
| Prepaid expenses and other current assets | 3,081 | 2,900 |
| Deferred income taxes | 418 | 282 |
| Total current assets | 30,471 | 37,339 |
| Property and equipment, net | 5,384 | 4,723 |
| Other assets | 2,349 | 2,330 |
| Deferred income taxes | 1,379 | 1,382 |
| Intangibles, net | 8,582 | 3,987 |
| Goodwill | 2,748 | 1,476 |
| Total assets | \$ 50,913 | \$ 51,237 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,465 | \$ 1,250 |
| Accrued expenses | 4,783 | 3,312 |
| Accrued salaries, wages and related benefits | 5,955 | 4,905 |
| Income and other taxes | 1,320 | 1,255 |
| Current portion of long term obligations | 1,421 | 1,582 |
| Deferred income taxes | - | 76 |
| Total current liabilities | 14,944 | 12,380 |
| Deferred income taxes | 701 | 716 |
| Long term obligations | 4,045 | 3,436 |
| Commitments and contingencies | | |
| Non-controlling interests | (3,557) | (3,507) |
| STOCKHOLDERS' EQUITY: | | |
| Serial preferred stock; 5,000,000 shares authorized, none outstanding | - | - |
| Common stock, \$.01 par value; 75,000,000 shares authorized; 27,305,000 shares issued and 25,624,000 outstanding at September 30, 2016 and 27,069,000 shares issued and 25,445,000 outstanding at December 31, 2015 | 273 | 270 |

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| | | |
|---|-----------|-----------|
| Additional paid-in capital | 25,624 | 24,590 |
| Retained earnings | 13,383 | 17,924 |
| Accumulated other comprehensive income (loss) | 122 | (84) |
| | 39,402 | 42,700 |
| Less: treasury stock, 1,681,000 shares at September 30, 2016 and 1,624,000 shares at December 31, 2015, at cost | (4,622) | (4,488) |
| Total stockholders' equity | 34,780 | 38,212 |
| Total liabilities and stockholders' equity | \$ 50,913 | \$ 51,237 |

See notes to condensed consolidated financial statements.

INNODATA INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS****(Unaudited)****(In thousands, except per share amounts)**

| | Three Months Ended September 30, | |
|---|-------------------------------------|-----------|
| | 2016 | 2015 |
| Revenues | \$ 16,060 | \$ 15,135 |
| Operating costs and expenses: | | |
| Direct operating costs | 12,422 | 10,452 |
| Selling and administrative expenses | 5,105 | 3,941 |
| Change in fair value of contingent consideration | 1,038 | - |
| Interest expense, net | 15 | 6 |
| Totals | 18,580 | 14,399 |
| Income (loss) before income taxes | (2,520) | 736 |
| Provision for income taxes | 352 | 462 |
| Net income (loss) | (2,872) | 274 |
| Loss attributable to non-controlling interests | 106 | 132 |
| Net income (loss) attributable to Innodata Inc. and Subsidiaries | \$ (2,766) | \$ 406 |
| Income (loss) per share attributable to Innodata Inc. and Subsidiaries: | | |
| Basic and diluted | \$ (0.11) | \$ 0.02 |
| Weighted average shares outstanding: | | |
| Basic and diluted | 25,651 | 25,455 |
| Comprehensive loss: | | |
| Net income (loss) | \$ (2,872) | \$ 274 |
| Pension liability adjustment, net of taxes | (83) | 10 |
| Change in fair value of derivatives, net of taxes | (39) | (426) |
| Foreign currency translation adjustment, net of taxes | (118) | (393) |
| Other Comprehensive loss | (240) | (809) |
| Total Comprehensive loss | (3,112) | (535) |
| Comprehensive loss attributed to non-controlling interest | 106 | 132 |
| Comprehensive loss attributable to Innodata Inc. and Subsidiaries | \$ (3,006) | \$ (403) |

See notes to condensed consolidated financial statements.

INNODATA INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS****(Unaudited)****(In thousands, except per share amounts)**

| | Nine Months Ended September 30, | |
|---|------------------------------------|-------------|
| | 2016 | 2015 |
| Revenues | \$ 47,400 | \$ 43,000 |
| Operating costs and expenses: | | |
| Direct operating costs | 35,572 | 32,567 |
| Selling and administrative expenses | 14,469 | 12,354 |
| Change in fair value of contingent consideration | 1,038 | - |
| Interest expense (income), net | 44 | (39) |
| Totals | 51,123 | 44,882 |
| Loss before income taxes | (3,723) | (1,882) |
| Provision for income taxes | 1,128 | 763 |
| Net loss | (4,851) | (2,645) |
| Loss attributable to non-controlling interests | 310 | 412 |
| Net loss attributable to Innodata Inc. and Subsidiaries | \$ (4,541) | \$ (2,233) |
| Loss per share attributable to Innodata Inc. and Subsidiaries: | | |
| Basic and diluted | \$ (0.18) | \$ (0.09) |
| Weighted average shares outstanding: | | |
| Basic and diluted | 25,514 | 25,377 |
| Comprehensive loss: | | |
| Net loss | \$ (4,851) | \$ (2,645) |
| Pension liability adjustment, net of taxes | (247) | 30 |
| Change in fair value of derivatives, net of taxes | 207 | 57 |
| Foreign currency translation adjustment, net of taxes | 246 | (813) |
| Other Comprehensive income (loss) | 206 | (726) |
| Total Comprehensive loss | (4,645) | (3,371) |
| Comprehensive loss attributed to non-controlling interest | 310 | 412 |
| Comprehensive loss attributable to Innodata Inc. and Subsidiaries | \$ (4,335) | \$ (2,959) |

See notes to condensed consolidated financial statements.

INNODATA INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)
(In thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-------------|
| | 2016 | 2015 |
| Cash flow from operating activities: | | |
| Net loss | \$ (4,851) | \$ (2,645) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 2,200 | 2,113 |
| Stock-based compensation | 729 | 800 |
| Deferred income taxes | (289) | (218) |
| Pension cost | 100 | 397 |
| Change in fair value of contingent consideration | 1,038 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 487 | 1,152 |
| Prepaid expenses and other current assets | (78) | 111 |
| Other assets | (272) | 69 |
| Accounts payable and accrued expenses | (1,092) | (86) |
| Accrued salaries, wages and related benefits | 985 | 566 |
| Income and other taxes | (80) | 7 |
| Net cash provided by (used in) operating activities | (1,123) | 2,266 |
| Cash flow from investing activities: | | |
| Capital expenditures | (2,051) | (466) |
| Acquisition of business | (4,052) | - |
| Net cash used in investing activities | (6,103) | (466) |
| Cash flow from financing activities: | | |
| Payment of long term obligations | (419) | (848) |
| Purchase of treasury stock | (134) | (100) |
| Net cash used in financing activities | (553) | (948) |
| Effect of exchange rate changes on cash and cash equivalents | 148 | (147) |
| Net increase (decrease) in cash and cash equivalents | (7,631) | 705 |
| Cash and cash equivalents, beginning of period | 24,908 | 24,216 |
| Cash and cash equivalents, end of period | \$ 17,277 | \$ 24,921 |

Supplemental disclosure of cash flow information:

| | | |
|--|--------|--------|
| Cash paid for income taxes | \$ 928 | \$ 768 |
| Common stock issued for MediaMiser acquisition | \$ 569 | \$ - |

See notes to condensed consolidated financial statements.

INNODATA INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

(In thousands)

| | Common Stock | | Additional Paid-in | Retained | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|---|--------------|--------|-----------------------|-----------|---|-------------------|-----------|
| | Shares | Amount | Capital | Earnings | | | |
| January 1, 2016 | 25,445 | \$ 270 | \$ 24,590 | \$ 17,924 | \$ (84) | \$ (4,488) | \$ 38,212 |
| Net loss | - | - | - | (4,541) | - | - | (4,541) |
| Stock-based compensation | - | - | 729 | - | - | - | 729 |
| Issuance of common stock | 236 | 3 | 566 | - | - | - | 569 |
| Acquisition of non-controlling interest | - | - | (261) | - | - | - | (261) |
| Pension liability adjustments, net of taxes | - | - | - | - | (247) | - | (247) |
| Foreign currency translation adjustment, net of taxes | - | - | - | - | 246 | - | 246 |
| Change in fair value of derivatives, net of taxes | - | - | - | - | 207 | - | 207 |
| Purchase of treasury stock | (57) | - | - | - | - | (134) | (134) |
| September 30, 2016 | 25,624 | \$ 273 | \$ 25,624 | \$ 13,383 | \$ 122 | \$ (4,622) | \$ 34,780 |
| January 1, 2015 | 25,337 | \$ 268 | \$ 22,780 | \$ 20,750 | \$ (287) | \$ (4,288) | \$ 39,223 |
| Net loss | - | - | - | (2,233) | - | - | (2,233) |
| Stock-based compensation | - | - | 800 | - | - | - | 800 |
| Issuance of common stock | 187 | 2 | 484 | - | - | - | 486 |
| Pension liability adjustments, net of taxes | - | - | - | - | 30 | - | 30 |
| Foreign currency translation adjustment, net of taxes | - | - | - | - | (813) | - | (813) |
| Change in fair value of derivatives, net of taxes | - | - | - | - | 57 | - | 57 |
| Purchase of treasury stock | (40) | - | - | - | - | (100) | (100) |
| September 30, 2015 | 25,484 | \$ 270 | \$ 24,064 | \$ 18,517 | \$ (1,013) | \$ (4,388) | \$ 37,450 |

See notes to condensed consolidated financial statements.

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

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

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

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

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

The Company’s MIS segment provides media monitoring and analysis software and professional services for organizations of all sizes. Through innovative web-based and mobile solutions, MIS reduces the time and effort it takes to gather, analyze and distribute valuable business intelligence extracted from traditional and social media sources. Through Bulldog Reporter, MIS provides PR industry newsletters, a journalist database, media intelligence and professional development programs. The Company’s MIS segment operates through its MediaMiser, Bulldog

Reporter and Agility subsidiaries.

In July 2016, the MediaMiser subsidiary acquired Agility from PR Newswire under an asset purchase agreement. Agility is a leading global media contact database and media monitoring platform that helps customers target key influencers, amplify content and measure impact. The solution is offered as software-as-a-service (SaaS). MediaMiser acquired Agility to foster growth in North America and Europe by bolstering MediaMiser's media intelligence solutions and media databases, improving its media outreach capabilities, and delivering stronger, more data-powered media intelligence to clients. With the acquisition of Agility, MediaMiser is now one of only a handful of companies able to offer a global media contact dataset with integrated workflows for distribution, monitoring and measurement.

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

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

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

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

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

The functional currency of the foreign subsidiaries located in Germany, Canada and United Kingdom are the euro, Canadian dollar and pound sterling, respectively. The financial statements of these subsidiaries are reported in these

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

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

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

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

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

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

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

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

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

2. Property and Equipment

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

| | September 30, 2016 | December 31, 2015 |
|---|-----------------------|----------------------|
| Equipment | \$ 14,759 | \$ 13,437 |
| Software | 5,396 | 5,089 |
| Furniture and equipment | 2,124 | 2,313 |
| Leasehold improvements | 4,908 | 4,956 |
| Total | 27,187 | 25,795 |
| Less: accumulated depreciation and amortization | (21,803) | (21,072) |
| | \$ 5,384 | \$ 4,723 |

Depreciation and amortization expense of property and equipment was approximately \$0.5 million for the three months ended September 30, 2016 and 2015, respectively. Depreciation and amortization expense of property and equipment was approximately \$1.5 million for the nine months ended September 30, 2016 and 2015, respectively.

3. Acquisitions

On July 14, 2016, Innodata's MediaMiser subsidiary completed the acquisition of Agility from PR Newswire under an asset purchase agreement for a cash consideration of \$4.1 million.

Agility is a leading global media contact database and media monitoring platform that helps customers target key influencers, amplify content and measure impact. The solution is offered as software-as-a-service (SaaS).

MediaMiser acquired Agility to foster growth in North America and Europe by bolstering MediaMiser's media intelligence solutions and media databases, improving its media outreach capabilities, and delivering stronger, more data-powered media intelligence to clients. With the acquisition of Agility, MediaMiser is now one of only a handful of companies able to offer a global media contact dataset with integrated workflows for distribution, monitoring and measurement.

As this acquisition was effective on July 14, 2016, the results of operations of Agility are included in the condensed consolidated financial statements for the period beginning July 14, 2016. The transaction has been accounted for using the acquisition method of accounting. This method requires that assets acquired and liabilities assumed in a business combination be recognized at their fair values as of the acquisition date. The excess of the purchase price over the net assets acquired was recorded as goodwill.

The Company has obtained third party valuations of certain intangible assets. The following table summarizes (in thousands) the preliminary purchase price allocation for the acquisition:

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

| | Amount |
|--|----------|
| Accounts receivable | \$ 795 |
| Media contact database | 3,610 |
| Developed technology | 994 |
| Tradenames and trademarks | 310 |
| Total identifiable assets acquired | 5,709 |
| Accounts payable and accrued expenses | 176 |
| Accrued salaries, wages and related benefits | 63 |
| Deferred revenues | 2,560 |
| Income and other taxes | 97 |
| Total liabilities assumed | 2,896 |
| Net identifiable assets acquired | 2,813 |
| Goodwill | 1,239 |
| Net assets acquired | \$ 4,052 |

The estimated fair value of the media contact database and tradenames and trademarks intangible assets was determined using the “relief from royalty method” under the income approach, which is a valuation technique that provides an estimate of the fair value of an asset based on the cost savings that are available through ownership of the asset by the avoidance of paying royalties to license the use of the asset from another owner. The estimated fair value of the developed technology was determined based on the cost approach, which measures the value by the cost to reconstruct or replace the platform with another of like utility. Some of the more significant assumptions inherent in the development of these asset valuations include the projected revenue associated with the asset, the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset’s life cycle, as well as other factors. The discount rate used to arrive at the present value of the media contact database and tradenames and trademarks at the acquisition date, was 13.5%. The remaining useful lives of the media contact database, developed technology, and tradenames and trademarks were based on historical product development cycles, the projected rate of technology migration, a market participant’s use of these intangible assets and the pattern of projected economic benefit of these intangible assets.

The amounts assigned to the media contact database, developed technology, tradenames and trademarks are amortized over the estimated useful life of 10 years.

The Company funded the purchase price from its available cash on hand. Transaction expenses amounted to \$0.1 million and have been expensed.

The following unaudited pro forma summary presents consolidated information of the Company as if the business combination had occurred on January 1, 2015 (amount in thousands, except per share amounts). The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time or that may result in the future.

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues: | | | | |
| As reported | \$ 16,060 | \$ 15,135 | \$ 47,400 | \$ 43,000 |
| Proforma | \$ 16,280 | \$ 16,410 | \$ 50,900 | \$ 46,650 |
| Net income (loss) attributable to Innodata Inc. and Subsidiaries: | | | | |
| As reported | \$ (2,766) | \$ 406 | \$ (4,541) | \$ (2,233) |
| Proforma | \$ (2,721) | \$ 389 | \$ (4,205) | \$ (2,299) |
| Basic and diluted net income (loss) per share: | | | | |
| As reported | \$ (0.11) | \$ 0.02 | \$ (0.18) | \$ (0.09) |
| Proforma | \$ (0.11) | \$ 0.02 | \$ (0.16) | \$ (0.09) |

4. Goodwill and Intangible Assets

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

| | |
|---|----------|
| Goodwill | |
| Balance as of January 1, 2016 | \$ 1,476 |
| Goodwill recorded in connection with an acquisition | 1,239 |
| Foreign currency translation adjustment | 33 |
| Balance as of September 30, 2016 | \$ 2,748 |
| | |
| Balance as of January 1, 2015 | \$ 1,635 |
| Foreign currency translation adjustment | (129) |
| Balance as of September 30, 2015 | \$ 1,506 |

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

| | Developed technology | Customer relationships | Trademarks and tradenames | Patents | Media Contact Database | Total |
|----------------------------------|-------------------------|---------------------------|---------------------------------|---------|------------------------------|---------|
| Gross carrying amounts: | | | | | | |
| Balance as of January 1, 2016 | \$ 1,978 | \$ 2,036 | \$ 555 | \$ 41 | \$ - | \$4,610 |
| Additions | 994 | - | 310 | - | 3,610 | 4,914 |
| Foreign currency translation | 98 | 108 | 10 | 3 | (25) | 194 |
| Balance as of September 30, 2016 | \$ 3,070 | \$ 2,144 | \$ 875 | \$ 44 | \$ 3,585 | \$9,718 |

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

| | Developed technology | Customer relationships | Trademarks and tradenames | Patents | Media Contact Database | Total |
|----------------------------------|-------------------------|---------------------------|---------------------------------|---------|------------------------------|---------|
| Gross carrying amounts: | | | | | | |
| Balance as of January 1, 2015 | \$ 2,369 | \$ 2,439 | \$ 596 | \$ 50 | \$ - | \$5,454 |
| Foreign currency translation | (317) | (327) | (32) | (7) | - | (683) |
| Balance as of September 30, 2015 | \$ 2,052 | \$ 2,112 | \$ 564 | \$ 43 | \$ - | \$4,771 |

| | Developed technology | Customer relationships | Trademarks and tradenames | Patents | Media Contact Database | Total |
|----------------------------------|-------------------------|---------------------------|---------------------------------|---------|------------------------------|---------|
| Accumulated amortization: | | | | | | |
| Balance as of January 1, 2016 | \$ 280 | \$ 240 | \$ 98 | \$ 5 | \$ - | \$623 |
| Amortization expense | 180 | 133 | 75 | 3 | 90 | 481 |
| Foreign currency translation | 16 | 14 | 1 | 2 | (1) | 32 |
| Balance as of September 30, 2016 | \$ 476 | \$ 387 | \$ 174 | \$ 10 | \$ 89 | \$1,136 |

| | Developed technology | Customer relationships | Trademarks and tradenames | Patents | Media Contact Database | Total |
|----------------------------------|-------------------------|---------------------------|---------------------------------|---------|------------------------------|-------|
| Accumulated amortization: | | | | | | |
| Balance as of January 1, 2015 | \$ 98 | \$ 84 | \$ 11 | \$ - | \$ - | \$193 |
| Amortization expense | 168 | 144 | 69 | 4 | - | 385 |
| Foreign currency translation | (27) | (23) | (3) | - | - | (53) |
| Balance as of September 30, 2015 | \$ 239 | \$ 205 | \$ 77 | \$ 4 | \$ - | \$525 |

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

Amortization expense relating to acquisition-related intangible assets was \$0.5 million and \$0.4 million for the nine months ended September 30, 2016 and 2015, respectively.

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

| Year | Amortization |
|------------|--------------|
| 2016 | \$ 242 |
| 2017 | 969 |
| 2018 | 969 |
| 2019 | 969 |
| 2020 | 903 |
| Thereafter | 4,530 |
| | \$ 8,582 |

5. Income Taxes

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

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

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

| | Unrecognized tax benefits |
|---|------------------------------|
| Balance - January 1, 2016 | \$ 1,207 |
| Decrease for tax position settled for prior years | (108) |
| Increase for tax provision | 40 |
| Interest accrual | 47 |
| Foreign currency revaluation | 2 |
| Balance - September 30, 2016 | \$ 1,188 |

The Company is subject to Federal income tax, as well as income tax in various states and foreign jurisdictions. The Company is no longer subject to examination by Federal tax authorities for years prior to 2006 and by New Jersey tax authorities for years prior to 2012. Various foreign subsidiaries currently have open tax years from 2003 through 2016.

Pursuant to an income tax audit by the Indian Bureau of Taxation in 2009, the Company's Indian subsidiaries received a tax assessment approximating \$312,000 including interest, through September 30, 2016 for the fiscal year ended March 31, 2006. Management disagrees with the basis of these tax assessments, has filed an appeal against the assessments and is contesting them vigorously. In January 2012, the Indian subsidiary received a final tax assessment of approximately \$1.0 million, including interest, for the fiscal year ended March 31, 2008, from the Indian Bureau of Taxation. Management disagrees with the basis of this tax assessment, and has filed an appeal against it. Due to this assessment, the Company recorded a tax provision amounting to \$496,000 including interest through September 30, 2016. In April 2015, the Company received a favorable judgment whereby the Appeal Officer reduced the tax assessment to \$0.3 million. Under the Indian Income Tax Act, however, the income tax assessing officer has the right to appeal against the judgment passed by the Appeal Officer. In the third quarter of 2015, the income tax assessing officer exercised this right and filed an appeal. Based on recent experience, management believes that the tax provision of \$496,000 including interest is adequate. As the Company is continually subject to tax audits by the Indian Bureau of Taxation, the Company continuously assesses the likelihood of an unfavorable assessment for all fiscal years for which the Company has not been audited and, as of September 30, 2016, the Company recorded a tax provision amounting to \$158,000 including interest for such year.

In 2015 the Company's Indian subsidiary was subject to an inquiry by the Service Tax Bureau in India regarding the classification of services provided by this subsidiary, asserting that the services provided by this subsidiary fall under the category of online information and database access or retrieval services (OID Services), and not under the category of business support services (BS Services) that are exempt from service tax as historically indicated in the subsidiary's service tax filings. In the event the Service Tax Bureau is successful in proving that the services fall under the category of OID Services the revenues earned by the Company's Indian subsidiary would be subject to a service tax of approximately 14.5% of revenues and this would increase the operating costs of the Company by an equivalent amount. The revenues of the Company's Indian subsidiary for the nine months ended September 30, 2016 were \$12.7 million. The Company disagrees with the Service Tax Bureau's position and is contesting these assertions vigorously.

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

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

From time to time the Company is also subject to various other tax proceedings and claims for its India and Philippines subsidiaries. The Company has recorded a tax provision amounting to \$222,000 including interest through September 30, 2016, for several other ongoing tax proceedings in India and the Philippines. Although the ultimate outcome cannot be determined at this time, the Company continues to contest these claims vigorously.

In the third quarter of 2016, the U.S. entity deferred \$3.8 million in payments due to its Asian operating subsidiaries. The deferral in payments resulted in a deemed dividend that is taxable income to the U.S. entity and is set off against its net operating loss carryforwards. The Company projects that during the period from October 1, 2016 through 2018 the U.S. entity may not have sufficient cash to pay in full amounts that will be payable by it to the Company's Asian operating subsidiaries and that the cash deficit will amount to approximately \$2.2 million. The resulting deferral in payments would similarly result in a deemed dividend that would be taxable income to the U.S. entity and would be set off against its net operating loss carryforwards. The Company adjusted its deferred tax assets and the corresponding valuation allowance as of September 30, 2016 to reflect the projected deferral through 2018.

6. Commitments and Contingencies

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

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

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

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

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

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

Liens-In connection with the procurement of tax incentives at one of the Company's foreign subsidiaries, the foreign zoning authority was granted a first lien on the subsidiary's property and equipment. As of September 30, 2016, the net book value of the property and equipment was \$0.5 million.

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

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

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

| | Number of Options | Weighted - Average Exercise Price | Weighted -Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|----------------------|---|--|------------------------------|
| Outstanding at January 1, 2016 | 3,970,146 | \$ 3.02 | | |
| Granted | 750,000 | 2.65 | | |
| Exercised | - | - | | |
| Forfeited/Expired | (240,977) | 3.13 | | |
| Outstanding at September 30, 2016 | 4,479,169 | \$ 2.95 | 5.34 | \$ 46,400 |
| Exercisable at September 30, 2016 | 2,409,156 | \$ 3.12 | 4.02 | \$ 5,940 |
| Vested and Expected to Vest at September 30, 2016 | 4,479,169 | \$ 2.95 | 5.34 | \$ 46,400 |

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|------|
| | 2016 | 2015 |
| Weighted average fair value of options granted | \$ 1.08 | \$ - |
| Risk-free interest rate | 1.26% - 1.49 % | - |
| Expected life (years) | 5-6 | - |
| Expected volatility factor | 49 % | - |
| Expected dividends | - | - |

The total compensation cost related to non-vested stock awards not yet recognized as of September 30, 2016 totaled approximately \$1.5 million. The weighted-average period over which these costs will be recognized is twenty four months.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|-------------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Direct operating costs | \$ 81 | \$ 98 | \$ 245 | \$ 293 |
| Selling and administrative expenses | 126 | 143 | 484 | 507 |
| Total stock-based compensation | \$ 207 | \$ 241 | \$ 729 | \$ 800 |

There were no options exercised in the nine months ended September 30, 2016.

INNODATA INC. AND SUBSIDIARIES**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(Unaudited)****8. Long term obligations**

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

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| Vendor obligations | | |
| Capital lease obligations ⁽¹⁾ | \$ 307 | \$ 423 |
| Deferred lease payments ⁽²⁾ | 707 | 707 |
| Microsoft licenses ⁽³⁾ | 173 | 360 |
| Acquisition related liability ⁽⁴⁾ | 1,515 | 993 |
| Pension obligations | | |
| Accrued pension liability | 2,764 | 2,535 |
| | 5,466 | 5,018 |
| Less: Current portion of long term obligations | 1,421 | 1,582 |
| Totals | \$ 4,045 | \$ 3,436 |

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

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

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

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

⁽⁴⁾ On September 30, 2016 the Company and the other parties to the transaction in which the Company acquired MediaMiser amended the terms on which a subsidiary of the Company is required to make a supplemental purchase price payment for MediaMiser. Prior to the amendment, the amount of the supplemental purchase price payment was to be determined by the achievement of certain financial thresholds and was in no event to exceed \$3.8 million (C\$5 million). The amendment fixed the amount of the supplemental purchase price payment at \$1.5 million (C\$2 million) payable in two equal installments on March 31, 2017 and March 31, 2018 to designated recipients, except that no payments will be made to designated recipients who fail to satisfy specified conditions. The Company has the option to pay up to 70% of the supplemental amount in shares of Innodata Inc. stock.

9. Comprehensive Income (Loss)

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

| | Pension Liability Adjustment | Fair Value of Derivatives | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|--|---------------------------------|------------------------------|---|---|
| Balance at July 1, 2016 | \$1,359 | \$81 | \$(1,078 |) \$362 |
| Other comprehensive loss before reclassifications, net of taxes | - | (11 |) (118 |) (129 |
| Total other comprehensive income (loss) before reclassifications, net of taxes | 1,359 | 70 | (1,196 |) 233 |
| Net amount reclassified to earnings | (83 |) (28 |) - | (111 |
| Balance at September 30, 2016 | \$1,276 | \$42 | \$(1,196 |) \$122 |

| | Pension Liability Adjustment | Fair Value of Derivatives | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|--|---------------------------------|------------------------------|---|---|
| Balance at July 1, 2015 | \$517 | \$146 | \$(867 |) \$(204 |
| Other comprehensive loss before reclassifications, net of taxes | - | (486 |) (393 |) (879 |
| Total other comprehensive income (loss) before reclassifications, net of taxes | 517 | (340 |) (1,260 |) (1,083 |
| Net amount reclassified to earnings | 10 | 60 | - | 70 |
| Balance at September 30, 2015 | \$527 | \$(280 |) \$(1,260 |) \$(1,013 |

| | Pension Liability Adjustment | Fair Value of Derivatives | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|---|---------------------------------|------------------------------|---|---|
| Balance at January 1, 2016 | \$1,523 | \$(165 |) \$(1,442 |) \$(84 |
| Other comprehensive income before reclassifications, net of taxes | - | 223 | 246 | 469 |

| | | | | | |
|--|---------|------|----------|---|-------|
| Total other comprehensive income (loss) before reclassifications, net of taxes | 1,523 | 58 | (1,196 |) | 385 |
| Net amount reclassified to earnings | (247 |) | (16 |) | - |
| Balance at September 30, 2016 | \$1,276 | \$42 | \$(1,196 |) | \$122 |

| | Pension Liability Adjustment | Fair Value of Derivatives | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|--|---------------------------------|------------------------------|---|---|
| Balance at January 1, 2015 | \$497 | \$(337) | \$(447) | \$(287) |
| Other comprehensive loss before reclassifications, net of taxes | - | (81) | (813) | (894) |
| Total other comprehensive income (loss) before reclassifications, net of taxes | 497 | (418) | (1,260) | (1,181) |
| Net amount reclassified to earnings | 30 | 138 | - | 168 |
| Balance at September 30, 2015 | \$527 | \$(280) | \$(1,260) | \$(1,013) |

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

10. Segment Reporting and Concentrations

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

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

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

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

In July 2014, the Company acquired MediaMiser, an Ottawa, Canada-based provider of automated, real-time traditional and social media monitoring services. In December 2014, the Company acquired intellectual property and related assets of Bulldog Reporter. On July 14, 2016, Innodata's MediaMiser subsidiary acquired Agility. All these businesses constitute the Company's MIS segment.

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|---------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues: | | | | |
| DDS | \$ 12,052 | \$ 13,474 | \$38,928 | \$38,035 |
| IADS | 1,028 | 484 | 3,090 | 1,434 |
| MIS | 2,980 | 1,177 | 5,382 | 3,531 |
| Total Consolidated | \$ 16,060 | \$ 15,135 | \$47,400 | \$43,000 |
| Income (loss) before provision for income taxes ⁽¹⁾ : | | | | |
| DDS | \$ (1,132) |) \$ 2,534 | \$1,195 | \$3,596 |
| IADS | (1,296) |) (1,496) |) (3,754 |) (4,590) |
| MIS | (92) |) (302) |) (1,164 |) (888) |

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| | | | | | | | |
|--|-----------|---|----------|----------|---|----------|---|
| Total Consolidated | \$ (2,520 |) | \$ 736 | \$(3,723 |) | \$(1,882 |) |
| Income (loss) before provision for income taxes ⁽²⁾ : | | | | | | | |
| DDS | \$ (1,882 |) | \$ 1,892 | \$(980 |) | \$1,755 | |
| IADS | (553 |) | (861 |) (1,598 |) | (2,773 |) |
| MIS | (85 |) | (295 |) (1,145 |) | (864 |) |
| Total Consolidated | \$ (2,520 |) | \$ 736 | \$(3,723 |) | \$(1,882 |) |

| | September 30, 2016 | December 31, 2015 |
|--------------------|---------------------------|--------------------------|
| Total assets: | | |
| DDS | \$29,505 | \$41,842 |
| IADS | 735 | 1,026 |
| MIS | 20,673 | 8,369 |
| Total Consolidated | \$50,913 | \$51,237 |

⁽¹⁾ Before elimination of any inter-segment profits

⁽²⁾ After elimination of any inter-segment profits

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

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|----------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| United States | \$ 8,263 | \$ 7,275 | \$ 24,614 | \$ 20,478 |
| The Netherlands | 2,006 | 2,514 | 7,096 | 7,274 |
| United Kingdom | 2,417 | 2,520 | 6,397 | 6,771 |
| Canada | 1,491 | 1,472 | 4,465 | 4,298 |
| Other - principally Europe | 1,883 | 1,354 | 4,828 | 4,179 |
| | \$ 16,060 | \$ 15,135 | \$ 47,400 | \$ 43,000 |

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

| | September 30, 2016 | December 31, 2015 |
|--------------------|-----------------------|----------------------|
| United States | \$ 4,676 | \$ 1,104 |
| Foreign countries: | | |
| Canada | 5,121 | 635 |
| United Kingdom | 2,548 | - |
| Philippines | 1,991 | 5,223 |
| India | 1,639 | 1,611 |
| Sri Lanka | 689 | 1,580 |
| Israel | 48 | 31 |
| Germany | 2 | 2 |
| Total foreign | 12,038 | 9,082 |
| | \$ 16,714 | \$ 10,186 |

Two clients in the DDS Segment generated approximately 27% of the Company's total revenues for the three months ended September 30, 2016 and 34% of the Company's total revenues for the three months ended September 30, 2015. Another client in the DDS segment accounted for less than 10% of the Company's total revenues for the three months ended September 30, 2016 but accounted for 10% of the Company's total revenues for the three months ended September 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the three months ended September 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 52%, respectively, of the Company's total revenues.

Two clients in the DDS Segment generated approximately 30% of the Company's total revenues for the nine months ended September 30, 2016 and 34% of the Company's total revenues for the nine months ended September 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the nine months ended September 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 52%, respectively, of the Company's total revenues.

As of September 30, 2016, approximately 53% of the Company's accounts receivable was from foreign (principally European) clients and 55% of accounts receivable was due from four clients. As of December 31, 2015, approximately 62% of the Company's accounts receivable was from foreign (principally European) clients and 68% of accounts receivable was due from four clients.

INNODATA INC. AND SUBSIDIARIES**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(Unaudited)****11. Income (Loss) Per Share**

| | Three months ended September 30, 2016 | | Nine months ended September 30, 2016 | |
|--|---|----------|--|-------------|
| | 2015 | | 2015 | |
| | (in thousands) | | (in thousands) | |
| Net income (loss) attributable to Innodata Inc. and Subsidiaries | \$ (2,766 |) \$ 406 | \$ (4,541 |) \$ (2,233 |
| Weighted average common shares outstanding | 25,651 | 25,455 | 25,514 | 25,377 |
| Dilutive effect of outstanding options | - | - | - | - |
| Adjusted for dilutive computation | 25,651 | 25,455 | 25,514 | 25,377 |

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

Options to purchase 4.2 million shares and 3.4 million shares of common stock for the three months ended September 30, 2016 and 2015, respectively, were outstanding but not included in the computation of diluted net income (loss) per share, because the options exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive. In addition, diluted net income (loss) per share for the three months ended September 30, 2016 does not include 0.3 million potential shares of common stock derived from the exercise of stock options, because as a result of the Company’s incurring losses, their effect would have been anti-dilutive.

Options to purchase 4.2 million shares and 2.6 million shares of common stock for the nine months ended September 30, 2016 and 2015, respectively, were outstanding but not included in the computation of diluted net income (loss) per share, because the options exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive. In addition, diluted net loss per share for the nine months ended

September 30, 2016 and 2015 does not include 0.3 million and 0.8 million potential shares of common stock, respectively, derived from the exercise of stock options, because as a result of the Company's incurring losses, their effect would have been anti-dilutive.

12. Derivatives

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

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

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

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

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company does not hold or issue derivatives for trading purposes. All derivatives are recognized at their fair value and classified based on the instrument's maturity date. The total notional amount for outstanding derivatives as of September 30, 2016 and December 31, 2015 was \$17.7 million and \$15.8 million, respectively, which is comprised of cash flow hedges denominated in U.S. dollars.

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

| | Balance Sheet Location | Fair Value | |
|--|---|------------|-------|
| | | 2016 | 2015 |
| Derivatives designated as hedging instruments: | | | |
| Foreign currency forward contracts | Prepaid expenses and other current assets | \$42 | \$- |
| Foreign currency forward contracts | Accrued expenses | \$- | \$165 |

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

Three Months Ended Nine Months Ended

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| | September 30, | | September 30, | |
|--|---------------|-----------|---------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net gain (loss) recognized in OCI ⁽¹⁾ | \$ (11) | \$ (486) | \$ 223 | \$ (81) |
| Net gain (loss) reclassified from accumulated OCI into income ⁽²⁾ | \$ 28 | \$ (60) | \$ 16 | \$ (138) |
| Net gain recognized in income ⁽³⁾ | \$ - | \$ - | \$ - | \$ - |

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

⁽²⁾Effective portion classified within direct operating cost.

⁽³⁾There were no effective portions for the period presented.

13. Financial Instruments

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

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

INNODATA INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(Unaudited)

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

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

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

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

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

September 30, 2016 Level 1 Level 2 Level 3

Assets

| | | | |
|-------------|------|-------|------|
| Derivatives | \$ - | \$ 42 | \$ - |
|-------------|------|-------|------|

December 31, 2015 Level 1 Level 2 Level 3

Liabilities

| | | | |
|-------------|------|--------|------|
| Derivatives | \$ - | \$ 165 | \$ - |
|-------------|------|--------|------|

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

consolidated balance sheets.

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

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

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

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

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

Business Overview

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

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

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

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

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

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

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

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

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

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

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

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

The IADS subsidiaries have incurred losses since their inception in 2011. Our investment net of revenues in these subsidiaries in the third quarter of 2016 was approximately \$550,000 (consisting mainly of operating expenses). We wrote off all of the fixed assets of IADS in the third quarter of 2013 and have expensed all investments in IADS since that time. In the immediate future we intend to continue to invest in these subsidiaries net of revenues at the combined rate of \$0.5 to \$0.7 million per quarter.

MediaMiser, Bulldog Reporter and Agility constitute the MIS segment.

MediaMiser provides media monitoring and analysis software and professional services to several Fortune 500 companies and Canadian government institutions, as well as small- and medium-sized businesses. Through web-based and mobile solutions, MediaMiser enables companies to reduce the time and effort required to extract, analyze and share valuable business intelligence from traditional and social media sources.

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

Increasingly, companies looking to market their products, identify market opportunities and manage their reputations are seeking technology and technology-enabled services to help them keep pace with the proliferation of traditional and social media news sources. We believe that MediaMiser's technology platform is well suited to this need and will

provide MediaMiser with a competitive advantage as it seeks to expand into new geographical markets and penetrate further into its existing market.

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

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

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

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

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

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

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

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

Recent Development

As previously reported, during the first quarter of 2016 the Company became aware of certain potentially improper payments and related transactions made by or at the direction of certain foreign employees of a foreign subsidiary in connection with the inspection of the subsidiary's compliance with local employment-related tax requirements. The Audit Committee initiated an internal investigation into this matter with the assistance of independent counsel and other professionals, and voluntarily contacted the U.S. Department of Justice and the U.S. Securities and Exchange Commission to advise them of the internal investigation. Based upon the Audit Committee's investigation, which we believe has been substantially completed, the amounts in question are not material with respect to the Company's financial condition or results of operations. The employees concerned are no longer employed by the subsidiary. We are unable at this time to predict what, if any, action may be taken by governmental authorities or penalties or remedial measures they may seek. As of September 30, 2016 we have incurred approximately \$1.5 million in legal, professional and related costs and expenses related to the investigation. We expect to incur up to \$100,000 in additional costs relating to the investigation in the fourth quarter.

Revenues

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

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

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

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

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

Direct Operating Costs

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

Selling and Administrative Expenses

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

Adjusted EBITDA Performance Metric

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

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

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

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

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

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Adjusted EBITDA: | | | | |
| Net income (loss) attributable to Innodata Inc. and Subsidiaries | \$ (2,766) | \$ 406 | \$ (4,541) | \$ (2,233) |
| Depreciation and amortization | 876 | 677 | 2,200 | 2,113 |
| Stock-based compensation | 207 | 241 | 729 | 800 |
| Provision for income taxes | 352 | 462 | 1,128 | 763 |
| Change in fair value of contingent consideration | 1,038 | - | 1,038 | - |
| Interest expense (income), net | 15 | 6 | 44 | (39) |

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| | | | | | | | | |
|---------------------------|---------|---|----------|---|--------|---|--------|---|
| Non-controlling interests | (106 |) | (132 |) | (310 |) | (412 |) |
| Adjusted EBITDA | \$ (384 |) | \$ 1,660 | | \$ 288 | | \$ 992 | |

Results of Operations

We acquired Agility on July 14, 2016. The Results of Operations reflect the operations of Agility only for the period beginning on July 14, 2016 and ending on September 30, 2016.

Three Months Ended September 30, 2016 and 2015

Revenues

Total revenues were \$16.1 million for the three months ended September 30, 2016 compared to \$15.1 million for the three months ended September 30, 2015, an increase of approximately \$1.0 million or approximately 6%.

Revenues from the DDS segment were \$12.1 million and \$13.4 million for the three months ended September 30, 2016 and 2015, respectively, a decrease of approximately \$1.3 million or approximately 11%. This decrease is primarily attributable to reduced volume from e-book related services that we perform for a key client and as a result of pricing concessions to another key client, offset in part by increases in volume on a ramp-up on a new project for a European publisher and a ramp-up for a new customer for whom we began services in the fourth quarter of 2015.

Revenues from the IADS segment were \$1.0 million for the three months ended September 30, 2016 and \$0.5 million for the three months ended September 30, 2015, an increase of \$0.5 million or 100%. The increase primarily reflects additional volume from Synodex clients.

Revenues from the MIS segment were \$3.0 million and \$1.2 million for the three months ended September 30, 2016 and 2015, respectively, an increase of \$1.5 million or approximately 125%. The increase is attributable to revenue of Agility from the date of acquisition to September 30, 2016.

Two clients in the DDS Segment generated approximately 27% of the Company's total revenues for the three months ended September 30, 2016 and 34% of the Company's total revenues for the three months ended September 30, 2015. Another client in the DDS segment accounted for less than 10% of the Company's total revenues for the three months ended September 30, 2016 but accounted for 10% of the Company's total revenues for the three months ended September 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for

the three months ended September 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 52%, respectively, of the Company's total revenues.

Direct Operating Costs

Direct operating costs were \$12.4 million and \$10.5 million for the three months ended September 30, 2016 and 2015, respectively, an increase of \$1.9 million or 18%. Direct operating costs as a percentage of total revenues increased to 79% for the three months ended September 30, 2016 compared to 69% for the three months ended September 30, 2015.

Direct operating costs for the DDS segment were approximately \$9.6 million and \$8.9 million for the three months ended September 30, 2016 and 2015, respectively, an increase of \$0.7 million or 8%. The increase reflects an increase in labor costs, and also reflects foreign exchange losses that resulted from the strengthening of the U.S. dollar. Direct operating costs for the DDS segment as a percentage of DDS segment revenues were 80% and 66% for the three months ended September 30, 2016 and 2015, respectively.

Direct operating costs for the IADS segment were \$1.3 million for the three months ended September 30, 2016 and \$1.0 million for the three months ended September 30, 2015, net of intersegment profits. The increase in direct operating costs for the IADS segment primarily reflects an increase in production headcount. Direct operating costs for the IADS segment as a percentage of IADS segment revenues were 127% and 205% for the three months ended September 30, 2016 and 2015, respectively. The decrease in direct operating costs as a percentage of IADS segment revenues is principally attributable to 100% increase in IADS revenues.

Direct operating costs for the MIS segment were \$1.5 million and \$0.6 million for the three months ended September 30, 2016 and 2015, respectively. The increase in direct operating costs was on account of costs of Agility recorded from the date of acquisition to September 30, 2016. Included in Agility related costs are \$0.1 million of one-time restructuring and integration costs. Direct operating costs for the MIS segment as a percentage of MIS segment revenues were 50% and 53% for the three months ended September 30, 2016 and 2015, respectively. This decline in direct operating costs as a percentage of MIS segment revenues reflects that the cost structure of Agility relative to revenues is lower than the cost structure of MediaMiser.

Selling and Administrative Expenses

Selling and administrative expenses were \$5.1 million for the three months ended September 30, 2016 compared to \$3.9 million for the three months ended September 30, 2015, an increase of \$1.2 million or approximately 31%. Selling and administrative expenses as a percentage of total revenues increased to 32% for the three months ended September 30, 2016 from 26% for the three months ended September 30, 2015.

Selling and administrative expenses for the DDS segment were \$3.3 million and \$2.8 million in these respective periods, an increase of \$0.5 million or 18%. The increase primarily reflects new hire costs of sales personnel and \$0.2 million of legal, professional and other costs in connection with the internal investigation referred to under "Recent Development". Selling and administrative expenses for the DDS segment as a percentage of DDS segment revenues increased to 27% for the three months ended September 30, 2016 from 20% for the three months ended September 30, 2015. This increase as a percentage of revenues was caused by the increase in selling and administrative expense and the decline in DDS segment revenues.

Selling and administrative expenses for the IADS segment were \$0.3 million for each of the three months ended September 30, 2016 and 2015. Selling and administrative expenses for the IADS segment as a percentage of IADS segment revenues decreased to 26% for the three months ended September 30, 2016 compared to 73% for the three months ended September 30, 2015. The decrease in selling and administrative expenses as a percentage of IADS segment revenues was principally attributable to the 100% increase in IADS revenues.

Selling and administrative costs for the MIS segment were \$1.5 million and \$0.8 million for the three months ended September 30, 2016 and 2015, respectively. The increase reflects selling and administrative costs of Agility including \$250,000 of one-time restructuring and integration costs, as well as new hire costs in MediaMiser. Selling and administrative expenses for the MIS segment as a percentage of MIS segment revenues declined to 56% for the three months ended September 30, 2016 from 72% for the three months ended September 30, 2015. This decline reflects that the cost structure of Agility relative to revenues is lower than the cost structure of MediaMiser.

Contingent Consideration

On September 30, 2016 we and the other parties to the transaction in which we acquired MediaMiser amended the terms on which one of our subsidiaries is required to make a supplemental purchase price payment for MediaMiser. On September 30, 2016 we and the other parties to the MediaMiser acquisition amended the terms on which one of our subsidiaries is required to make a supplemental purchase price payment for MediaMiser. Prior to the amendment, the amount of the supplemental purchase price payment was to be determined by the achievement of certain financial thresholds and was in no event to exceed \$3.8 million (C\$5 million). The amendment fixed the amount of the supplemental purchase price payment at \$1.5 million (C\$2 million) payable in two equal installments on March 31, 2017 and March 31, 2018 to designated recipients, except that no payments will be made to designated recipients who fail to satisfy specified conditions. We have the option to pay up to 70% of the supplemental amount in shares of Innodata Inc. common stock. We recorded a \$1.0 million charge in our statement of operations for the third quarter of 2016 to reflect the amendment.

Income Taxes

We recorded a provision for income taxes of \$0.4 million and \$0.5 million for the three months ended September 30, 2016 and 2015, respectively. Taxes primarily consist of a provision for foreign taxes recorded in accordance with the local tax regulations by our foreign subsidiaries. Effective income tax rates are disproportionate due to the losses incurred by our U.S. entity and our Canadian subsidiary and a valuation allowance recorded on deferred taxes on these entities. Some of our foreign subsidiaries are subject to tax holidays or preferential tax rates which reduce our overall effective tax rate when compared to the U.S. statutory tax rate. In addition, the earnings of our foreign subsidiaries are not subject to tax in the U.S. unless the earnings are repatriated.

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

Net Loss

We incurred a net loss of \$2.8 million during the three months ended September 30, 2016 compared to net income of \$0.4 million during the three months ended September 30, 2015.

Net loss for the DDS segment was \$2.1 million for the three months ended September 30, 2016, compared to net income of \$1.6 million for the three months ended September 30, 2015, net of intersegment profits. The change was due to the decline in revenues and the increase in direct operating costs and selling and administrative expenses that were mentioned above, and to the charge to our operations referred to under “Contingent Consideration.”

Net loss for the IADS segment was \$0.6 million for the three months ended September 30, 2016 compared to \$0.9 million for the three months ended September 30, 2015, net of intersegment profits. The decline in net loss is primarily due to an increase in revenues.

Net loss for the MIS segment was \$0.1 million for the three months ended September 30, 2016 compared to \$0.3 million for the three months ended September 30, 2015.

Adjusted EBITDA

Adjusted EBITDA for the three months ended September 30, 2016 was a loss of \$0.4 million compared to income of \$1.7 million for the three months ended September 30, 2015, an increased loss of \$2.1 million. Adjusted EBITDA for the DDS segment was break-even compared to income of \$2.7 million for the three months ended September 30, 2016 and 2015, respectively. Adjusted EBITDA was a loss of \$0.6 million and a loss of \$0.9 million for the IADS segment for the three months ended September 30, 2016 and 2015, respectively. Adjusted EBITDA was \$0.2 million for the three months ended September 30, 2016 compared to a loss of \$0.1 million for the three months ended September 30, 2015 for the MIS segment.

Nine Months Ended September 30, 2016 and 2015

Revenues

Total revenues were \$47.4 million for the nine months ended September 30, 2016 compared to \$43.0 million for the nine months ended September 30, 2015, an increase of approximately \$4.4 million or approximately 10%.

Revenues from the DDS segment were \$38.9 million and \$38.0 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$0.9 million or 2%. This increase is primarily attributable to a ramp-up on a new project for a European publisher and a ramp-up for a new customer for whom services began in the fourth quarter of 2015. The increase was partially offset by reduced volume from certain non e-book clients including as a result of pricing concessions extended to one key client.

Revenues from the IADS segment were \$3.1 million and \$1.4 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$1.7 million or 121%. The increase primarily reflects additional volume from Synodex clients.

Revenues from the MIS segment were \$5.4 million and \$3.6 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$1.8 million or approximately 50%. The increase is attributable to revenue of Agility from the date of acquisition to September 30, 2016.

Two clients in the DDS Segment generated approximately 30% of the Company's total revenues for the nine months ended September 30, 2016 and 34% of the Company's total revenues for the nine months ended September 30, 2015. No other client accounted for 10% or more of total revenues during these periods. Further, for the nine months ended September 30, 2016 and 2015, revenues from non-U.S. clients accounted for 48% and 52%, respectively, of the Company's total revenues.

Direct Operating Costs

Direct operating costs were \$35.6 million and \$32.6 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$3.0 million or approximately 12%. Direct operating costs as a percentage of total

revenues decreased to 75% for the nine months ended September 30, 2016 compared to 76% for the nine months ended September 30, 2015.

Direct operating costs for the DDS segment were \$28.8 million and \$27.5 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$1.3 million or 5%. The increase in direct operating costs primarily reflects \$150,000 of costs incurred in connection with the internal investigation referred to under “Recent Development”, an increase in labor costs and the impact of foreign exchange losses on account of the strengthening of the U.S. dollar. Direct operating costs for the DDS segment as a percentage of DDS segment revenues were 74% for the nine months ended September 30, 2016 compared to 72% for the nine months ended September 30, 2015. The increase in direct operating costs as a percentage of DDS segment revenues primarily reflects an increase in DDS segment direct operating costs relative to an increase in revenues.

Direct operating costs for the IADS segment were \$3.7 million for the nine months ended September 30, 2016 and \$3.1 million for the nine months ended September 30, 2015, net of intersegment profits, an increase of \$0.6 million or 19%. The increase in direct operating costs for the IADS segment primarily reflects an increase in production headcount. Direct operating costs for the IADS segment as a percentage of IADS segment revenues were 119% and 221% for the nine months ended September 30, 2016 and 2015, respectively. The decrease in direct operating costs as a percentage of IADS segment revenues was principally attributable to the 121% increase in IADS revenues.

Direct operating costs for the MIS segment were \$3.1 million and \$2.0 million for the nine months ended September 30, 2016 and 2015, respectively, an increase of \$1.1 million or 55%. The increase in direct operating costs was on account of new hire costs, increase in content acquisition costs, and costs of Agility recorded from the date of acquisition to September 30, 2016. Included in Agility related costs are one-time restructuring and integration costs amounting to \$0.1 million. Direct operating costs for the MIS segment as a percentage of MIS segment revenues were 57% and 55% for the nine months ended September 30, 2016 and 2015, respectively. This increase in direct operating costs as a percentage of MIS segment is due to increase in costs in MediaMiser relative to the increase in revenues.

Selling and Administrative Expenses

Selling and administrative expenses were \$14.5 million for the nine months ended September 30, 2016 compared to \$12.4 million for the nine months ended September 30, 2015, an increase of \$2.1 million or approximately 17%. Selling and administrative expenses as a percentage of total revenues were 31% and 29% for the nine months ended September 30, 2016 and 2015, respectively.

Selling and administrative expenses for the DDS segment were \$10.1 million and \$8.7 million in these respective periods, an increase of \$1.4 million or 16%. The increase primarily reflects \$1.5 million of legal, professional and other costs in connection with the internal investigation referred to under “Recent Developments”, as well as new hire costs. Selling and administrative expenses for the DDS segment as a percentage of DDS segment revenues increased to 26% for the nine months ended September 30, 2016 from 23% for the nine months ended September 30, 2015. This increase as a percentage of revenues was caused by the increase in selling and administrative expense relative to increase in DDS segment revenues.

Selling and administrative expenses for the IADS segment for the respective periods were \$1.0 million and \$1.2 million, net of intersegment profits, a decline of \$0.2 million or 17%. The decrease in selling and administrative expenses is on account of cost optimization. Selling and administrative expenses for the IADS segment as a percentage of IADS segment revenues decreased to 32% for the nine months ended September 30, 2016 compared to 86% for the nine months ended September 30, 2015. The decrease in selling and administrative expenses as a percentage of IADS segment revenues was principally attributable to the 121% increase in IADS revenues.

Selling and administrative costs for the MIS segment were \$3.4 million and \$2.5 million for the nine months ended September 30, 2016 and 2015, respectively. The increase reflects selling and administrative costs of Agility including \$250,000 of one-time restructuring and integration costs, new hire costs in MediaMiser and \$150,000 of one-time legal and other expenses for the Agility acquisition. Selling and administrative expenses for the MIS segment as a percentage of MIS segment revenues declined to 66% for the nine months ended September 30, 2016 from 70% for the nine months ended September 30, 2015. This decline reflects that the cost structure of Agility relative to revenues is lower than the cost structure of MediaMiser.

Contingent Consideration

On September 30, 2016 we and the other parties to the transaction in which we acquired MediaMiser amended the terms on which one of our subsidiaries is required to make a supplemental purchase price payment for MediaMiser. Prior to the amendment, the amount of the supplemental purchase price payment was to be determined by the achievement of certain financial thresholds and was in no event to exceed \$3.8 million (C\$5 million). The amendment fixed the amount of the supplemental purchase price payment at \$1.5 million (C\$2 million) payable in two equal installments on March 31, 2017 and March 31, 2018 to designated recipients, except that no payments will be made to designated recipients who fail to satisfy specified conditions. We have the option to pay up to 70% of the supplemental amount in shares of Innodata Inc. stock. We recorded a \$1.0 million charge in our statement of operations for the third quarter of 2016 to reflect the amendment.

Income Taxes

For the nine months ended September 30, 2016, we recorded a provision for income taxes of \$1.1 million in accordance with local tax regulations for our foreign subsidiaries. Taxes primarily consist of a provision for foreign taxes recorded in accordance with the local tax regulations by our foreign subsidiaries. Effective income tax rates are disproportionate due to losses incurred by our U.S. entity and our Canadian subsidiary and a valuation allowance recorded on deferred taxes on these entities. Some of our foreign subsidiaries are subject to tax holidays or preferential tax rates which reduce our overall effective tax rate when compared to the U.S. statutory tax rate. In addition, the earnings of our foreign subsidiaries are not subject to tax in the U.S. unless the earnings are repatriated.

For the nine months ended September 30, 2015, we recorded a provision for income taxes of \$0.8 million. The provision for income taxes recorded by our foreign subsidiaries was partially offset by a reversal of a tax provision on account of a favorable outcome in two of the tax proceedings of our Indian subsidiary.

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

Net Loss

We generated a net loss of \$4.5 million during the nine months ended September 30, 2016 compared to a net loss of \$2.2 million during the nine months ended September 30, 2015.

Net loss for the DDS segment was \$1.8 million for the nine months ended September 30, 2016, compared to net income of \$1.5 million for the nine months ended September 30, 2015, net of intersegment profits. Increased revenues were partially offset by an increase in direct operating costs and selling and administrative expenses that were mentioned above, and to the charge to our operations referred to under "Contingent Consideration." The change was also caused by an increase in tax expense.

Net loss for the IADS segment was \$1.6 million for the nine months ended September 30, 2016 compared to \$2.8 million for the nine months ended September 30, 2015, net of intersegment profits. The decline in net loss is primarily due to an increase in revenues.

Net loss for the MIS segment was \$1.1 million and \$0.9 million for the nine months ended September 30, 2016 and 2015, respectively. This increased loss was due to one-time integration expenses and acquisition-related costs.

Adjusted EBITDA

Adjusted EBITDA for the nine months ended September 30, 2016 was \$0.3 million compared to income of \$1.0 million for the nine months ended September 30, 2015, a decline of \$0.7 million. Adjusted EBITDA for the DDS segment was \$2.5 million and \$4.2 million for the nine months ended September 30, 2016 and 2015, respectively, a decrease of \$1.8 million or approximately 40%. Adjusted EBITDA was a loss of \$1.6 million and a loss of \$2.8 million for the IADS segment for the nine months ended September 30, 2016 and 2015, respectively. Adjusted EBITDA was a loss of \$0.6 million compared to a loss of \$0.4 million for the MIS segment for the nine months ended September 30, 2016 and 2015, respectively.

Liquidity and Capital Resources

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

| | September 30, 2016 | December 31, 2015 |
|---------------------------|--------------------|-------------------|
| Cash and cash equivalents | \$ 17,277 | \$ 24,908 |
| Working Capital | 15,527 | 24,959 |

At September 30, 2016, we had cash and cash equivalents of \$17.3 million, of which \$15.7 million was held by our foreign subsidiaries located in Asia and \$1.6 million was held in the United States. If needed, amounts held by foreign subsidiaries can be repatriated to the United States to satisfy working capital needs of the U.S. entity, but under current law, such amounts would be subject to United States federal income taxes. As of September 30, 2016, our intent is to permanently reinvest these funds outside the United States, except for \$6.0 million in projected deemed dividends described below.

We have used, and plan to use, our cash and cash equivalents for (i) investments in IADS which are expected to be at the rate of \$0.5-\$0.7 million per quarter in the immediate future; (ii) the expansion of our other operations; (iii) general corporate purposes, including working capital; and (iv) possible business acquisitions. As of September 30, 2016, we had working capital of approximately \$15.5 million, as compared to working capital of approximately \$25.0 million as of December 31, 2015.

We believe that our existing cash and cash equivalents and internally generated funds will provide sufficient sources of liquidity to satisfy our financial needs for the next 12 months. However, we may curtail or lessen our continuing investments in our IADS segment and other segments, or reduce our operating expenses, if these funds are insufficient

and outside financing is not available on terms we find attractive.

On July 14, 2016, our MediaMiser subsidiary completed the acquisition of Agility from PR Newswire under an asset purchase agreement for a cash consideration of \$4.1 million.

In the third quarter of 2016, our U.S. entity deferred \$3.8 million in payments due to its Asian operating subsidiaries. The deferral in payments resulted in a deemed dividend that is taxable income to the U.S. entity and is set off against its net operating loss carryforwards. We project that during the period from October 1, 2016 through 2018 our U.S. entity may not have sufficient cash to pay in full amounts that will be payable by it to its Asian operating subsidiaries and that the cash deficit will amount to approximately \$2.4 million. The resulting deferral in payments would similarly result in a deemed dividend that would be taxable income to the U.S. entity and would be set off against its net operating loss carryforwards.

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

Net Cash Provided By (Used In) Operating Activities

Cash used in our operating activities for the nine months ended September 30, 2016 was \$1.1 million, resulting from a net loss of \$4.9 million and adjustments for non-cash items of \$3.8 million. Adjustments for non-cash items primarily consisted of \$2.2 million for depreciation and amortization, change in fair value of contingent consideration of \$1.0 million, stock option expense of \$0.7 million and reduction in tax provisions of \$0.3 million.

Cash provided by our operating activities for the nine months ended September 30, 2015 was \$2.3 million, resulting from a net loss of \$2.6 million, adjustments for non-cash items of \$3.1 million, and \$1.8 million provided by working capital changes. Adjustments for non-cash items primarily consisted of \$2.1 million for depreciation and amortization and stock option expense of \$0.8 million. Working capital activities primarily consisted of a source of cash of \$1.2 million as a result of net collections of accounts receivable and a source of cash of \$0.6 million for a decrease in accrued salaries, wages and related benefits.

Our days' sales outstanding (DSO) for the nine months ended September 30, 2016 was approximately 56 days as compared to 61 days for the year ended December 31, 2015. We calculate DSO for a reported period by first dividing the total revenues for the period by the average net accounts receivable for the period (which is the sum of the net accounts receivable at the beginning of the period and the net accounts receivable at the end of the period, divided by two), to yield an amount we refer to as the "accounts receivable turnover." Then we divide the total number of days within the reported period by the accounts receivable turnover to yield DSO expressed in number of days.

Net Cash Used In Investing Activities

For the nine months ended September 30, 2016, cash used in our investing activities was \$6.1 million. These expenditures consisted of \$4.1 million paid to acquire Agility in July 2016 and capital expenditures of \$2.0 million principally for the purchase of technology equipment including servers, network infrastructure and workstations. For the nine months ended September 30, 2015, cash used in our investing activities for capital expenditures was \$0.5 million. We continue to expense all capital expenditures for the IADS segment. During the next twelve months, we anticipate that capital expenditures for ongoing technology, equipment, infrastructure upgrades and development of our proprietary software platform, tools and technologies will approximate \$2.0 to \$3.0 million, a portion of which we

may finance.

Net Cash Used in Financing Activities

For the nine months ended September 30, 2016 and 2015, cash used in financing activities were comprised of total payments of long-term obligations of \$0.6 million and \$0.9 million.

Contractual Obligations

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

| Contractual Obligations | Payments Due by Period | | | | |
|------------------------------------|------------------------|---------------------|-----------|-----------|------------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Capital lease | \$307 | \$ 157 | \$ 150 | \$ - | \$ - |
| Vendor obligations | 173 | 173 | - | - | - |
| Non cancellable operating leases | 3,159 | 387 | 1,039 | 1,177 | 556 |
| Total contractual cash obligations | \$3,639 | \$ 717 | \$ 1,189 | \$ 1,177 | \$ 556 |

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

Inflation, Seasonality and Prevailing Economic Conditions

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

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

Our Synodex subsidiary experiences seasonal fluctuations in revenues. Typically volume declines in the third quarter of the calendar year whereas the fourth quarter volumes are generally higher than other calendar quarters. The seasonality is directly linked to the number of life insurance applications received by the insurance companies.

Critical Accounting Policies and Estimates

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

Recent Accounting Pronouncements

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest rate risk

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

Foreign currency risk

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

To mitigate the exposure of fluctuating future cash flows due to changes in foreign exchange rates, we entered into foreign currency forward contracts. These foreign currency forward contracts were entered into with a maximum term of twelve months and have an aggregate notional amount of approximately \$17.7 million as of September 30, 2016. The total unrealized gain on the outstanding hedges was \$0.1 million as of September 30, 2016.

The impact of foreign currency fluctuations will continue to present economic challenges to us and could negatively impact our overall results of operations. A 10% appreciation in the U.S. dollar's value relating to hedged currencies would decrease the forward contracts' fair value by approximately \$1.6 million as of September 30, 2016. Similarly, a 10% depreciation in the U.S. dollar's value relative to hedged currencies would increase the forward contracts' fair value by approximately \$2.0 million. Any increase or decrease in the fair value of our currency exchange-rate-sensitive forward contracts, if utilized, would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying cash flows.

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

Other than the aforementioned forward contracts, we have not engaged in any hedging activities nor have we entered into off-balance-sheet transactions or arrangements. In addition, as of September 30, 2016, our foreign locations held cash and cash equivalents totaling approximately \$15.7 million. These assets are exposed to foreign exchange risk arising from changes in foreign exchange rates. At present, we do not enter into any hedging instruments to mitigate foreign exchange risk on such assets; however, we may do so in the future.

Item 4. Controls and Procedures

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

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

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

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

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

We purchased 57,000 shares of our common stock, for a total cost of approximately \$0.1 million, during the three months ended September 30, 2016, as shown in the table below:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Value of Shares Available for Repurchase |
|----------------------|----------------------------------|------------------------------|--|--|
| July 1-31, 2016 | - | \$ - | - | \$ 1,800,000 |
| August 1-31, 2016 | 50,000 | \$ 2.34 | 50,000 | \$ 1,683,000 |
| September 1-30, 2016 | 7,000 | \$ 2.35 | 7,000 | \$ 1,667,000 |

In September 2011, our Board of Directors authorized the repurchase of up to \$2.0 million of our common stock in open market or private transactions. There is no expiration date associated with the program.

On July 28, 2016 we issued 236,000 shares of Innodata Inc. common stock as a portion of the purchase price consideration for the acquisition of MediaMiser. The issuance was exempt from registration under the Securities Act of 1933 pursuant to section 4(a)(2) thereof.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

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

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

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

101. INS XBRL Instance Document

101. SCH XBRL Taxonomy Extension Schema Document

101. CAL XBRL Taxonomy Extension Calculation Link base Document

101. DEF XBRL Taxonomy Extension Definition Link base Document

101. LAB XBRL Taxonomy Extension Label Link base Document

101. PRE XBRL Taxonomy Extension Presentation Link base Document

SIGNATURES

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

INNODATA INC.

Date: November 8, 2016 /s/ Jack Abuhoff
Jack Abuhoff
Chairman of the Board,
Chief Executive Officer and President

Date: November 8, 2016 /s/ O'Neil Nalavadi
O'Neil Nalavadi
Senior Vice President
Chief Financial Officer
and Principal Accounting Officer