

INNODATA INC
Form 10-K
March 14, 2014

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

FORM 10-K

(Mark One)

Annual report under section 13 or 15(d) of the securities exchange act of 1934
For the fiscal year ended December 31, 2013

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

Commission file number **0-22196**

INNODATA INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

13-3475943

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

**Three University Plaza
Hackensack, New Jersey**

(Address of principal executive offices)

07601

(Zip Code)

(201) 371-8000

(Registrant's telephone number)

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

Title of Each Class

Common Stock \$.01 par value
Preferred Stock Purchase Right

Name of Each Exchange on Which Registered

The Nasdaq Stock Market LLC
The Nasdaq Stock Market LLC

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

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

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

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

Indicate by check mark 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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer Non-accelerated filer 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 aggregate market value of the registrant's common stock held by non-affiliates of the registrant (based on the closing price reported on The Nasdaq Stock Market on June 30, 2013) was \$70,796,300.

The number of outstanding shares of the registrant's common stock, \$.01 par value, as of February 10, 2014 was 25,049,889.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for the 2014 Annual Meeting of Stockholders are incorporated by reference in Items 10,11,12,13 and 14 of Part III of this Form 10-K.

INNODATA INC
Form 10-K
For the Year Ended December 31, 2013

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PART I

Disclosures in this Form 10-K contain certain forward-looking statements, including without limitation, statements concerning our operations, economic performance, and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words “project,” “head start,” “believe,” “expect,” “should,” “anticipate,” “indicate,” “point to,” “forecast,” “likely” 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 segment (“IADS”) is a new venture with minimal revenues 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 Content Services clients and the ability of these clients to reduce, delay or cancel projects; continuing Content Services segment revenue concentration in a limited number of clients; continuing Content Services segment reliance on project-based work; inability to replace projects that are completed, canceled or reduced; depressed market conditions; changes in external market factors; the ability and willingness of our clients and prospective clients to execute business plans which give rise to requirements for digital content and professional services in knowledge processing; difficulty in integrating and deriving synergies from acquisitions, joint venture and strategic investments; potential undiscovered liabilities of companies that we acquire; changes in our business or growth strategy; the emergence of new or growing competitors; various other competitive and technological factors; and other risks and uncertainties indicated from time to time in our filings with the Securities and Exchange Commission.

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

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

Item 1. Business.

Business Overview

Innodata (NASDAQ: INOD) is a global provider of business process, information technology (IT) and professional services that are focused on digital enablement. Our clients comprise several of the world’s leading digital retailers that sell digital content; preeminent publishers and other providers of online business information products; and enterprises in information-intensive industries (such as aerospace, defense, financial services, healthcare, high technology, insurance, and manufacturing) that create and manage large volumes of content to support their products or operations.

We operate in two reporting segments: Content Services and Innodata Advanced Data Solutions.

Content Services (CS) Segment

Our CS 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.

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-imbedded 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. Areas of notable technical competency and innovation include high-quality, large-scale transformation from image and PDF formats into digital text in a wide variety of formats (XML, ePUB3, XHTML, etc.); extraction and transformation of complex unstructured legal, financial, medical and technical information to enriched, structured, normalized, and referenced information; and development and integration of technologies that relate to digital publishing workflow (including editorial and production systems), custom content management systems and digital asset management systems (including enterprise database technologies) and media-neutral content delivery systems (including portals, websites and mobile applications). Each of our technical competencies is supported by defined approaches, frameworks and methodologies. We have a special focus on XML and related structured information standards, and through its employees Innodata has played leadership roles in the development of such standards.

E-Book Production and Distribution

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 million e-book titles.

Information Product Development

We help our clients develop high-value information products and knowledge repositories. Our clients include four of the ten largest information industry companies in the world, spanning financial, legal, healthcare and scientific information. Information and publishing is a \$753 billion industry consisting of more than 7,000 publishers, information providers and software service firms worldwide. Many of our clients specialize in the scientific, technical and medical (STM) segment (estimated revenues of \$32.3 billion) and the legal, tax and regulatory (LTR) segment (estimated revenues of \$19.7 billion)¹. Both STM and LTR publishers make some or all of their revenues from the sale of information products created from the primary and secondary data produced by professionals and researchers (in the case of STM) or courts, legislatures, administrative bodies and rule-making institutions (in the case of LTR).

Outsell Inc. (January 24, 2014). "Information Industry Market Size & Share Rankings Report: Preliminary 2013
1 Results."

2

We enable our clients to rapidly develop new digital products without direct investments in staff, facilities and technology. We embrace agile development methodologies that provide the benefits of early solution visualization and an iterative development process that spans content, technology and user interface development. We use a combination of onsite project management, onshore solutions architecture and offshore globally distributed teams of developers, analysts and subject matter experts.

For example, a leading legal publisher sought to develop a new digital product that would provide lawyers and compliance officers a workflow tool for rule checking, rapid research and fact checking. The new digital tool needed to be accessible via laptops, smart phones and tablet devices. Moreover, it needed to be updated daily to maintain pace with rapid regulatory developments (it was destined to replace a printed loose leaf series that was updated only monthly). Our technology architects, developers and content analysts designed and implemented the new digital tool within budget and on schedule. Using the new digital tool, lawyers and compliance officers can now confidently react faster to their clients' increased regulatory burdens with up-to-date information.

For another leading global publisher, we developed an eReader application designed specifically for complex professional reference material. The publisher saw an opportunity to increase sales by re-publishing its printed reference works as e-books, but was unable to market them as e-books because existing eReader applications were built for simple fiction and trade books. We developed an eReader application for the client that changed this – it enabled advanced search, linking and cross-references to external sources, subscriber annotations, frequent textual updates and a host of other functions the publisher required in order to distribute its complex reference books as e-books over the iPad® as well as Android and Windows-enabled mobile devices.

Operational Support

We help our clients significantly lower the cost of maintaining their high-value information products, applications and systems. Clients for which we perform such services include five of the top ten leading legal, tax and regulatory information providers, three of the top ten credit and financial information providers, and four of the top ten scientific, technical and medical information providers. Relative to information products, our focus is on the underlying “content supply chain” activities that are necessary to maintain the product. These activities often include content aggregation; extraction; encoding; indexing and abstracting; fabrication; and distribution. We deliver these activities on an outsourced basis.

For example, for a leading provider of networking equipment, we provide digital enhancement and related production systems support for its product guides, release notes, configurations guides, installation guides and other documents.

For an \$8 billion leading provider of financial and news information, we aggregate public source documentation from a variety of government agencies, which it transforms, analyzes and extracts in order to support a real-time, high-value information product.

For a leading wholesale textbook distributor, we provide support and maintenance for its digital book platform, including its customizable bookshelf and eReader applications and its conversion and fulfillment processes.

Digital Content Supply Chain Strategy

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.

For a multinational information services company, we worked in conjunction with a client's internal teams to design new content architectures and implement new content technologies that enabled the client to migrate its operations away from process and technologies designed primarily for print output to new processes and technologies that were designed around the nature of the content itself and supported multiple simultaneous delivery channels.

A global information company had acquired two businesses that each collected, processed and managed some of the same public law content. The company recognized the opportunity to reduce cost by consolidating the processing of this overlapping content. To accomplish this cost savings, we implemented a new, consolidated workflow system using Alfresco and jBPM which provided a common framework for content reuse, while enabling content enrichment processes to be performed by external and internal resources in a fully managed environment.

For a publisher of legal treatises and practice guides and provider of on-demand learning, we created a future-state vision of operational workflows required to support an increasing array of technologies and online products. This future-state vision included recommendations regarding process improvements and new technologies.

Innodata Advanced Data Solutions (IADS) Segment

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.

IADS operates through its Synodex LLC and docGenix LLC subsidiaries. As of December 31, 2013 we owned 83% 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 piloted its APS.Extract® product for specific use with life, disability and long-term care insurance underwriting and claims and has cultivated a large number of interested clients in both the U.S. and the U.K. Most recently, Synodex launched its Synodex.Connect® platform to facilitate digital data exchange for underwriting workflows between independent brokers and insurance carriers, including delivery of Synodex's APS.Extract data and reports.

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.

As an example of our docGenix service, we provided a leading global investment company a new content management system for its complex derivatives agreements. The company is party to more than 5,000 derivative contracts where the impact of market changes and the counterparty and collateral changes require daily verification and analysis. Conducting this research was slow and resource-intensive because contract creation, storage and retrieval processes were all still paper or image based. Using docGenix's system, these complex documents are transformed into machine readable, computer-addressable data that is downstreamed to risk collateral and other mission-critical systems, and users can perform multi-dimensional, complex queries in minutes.

The IADS subsidiaries are in a developmental stage and have incurred losses since inception and have reported minimal revenues through 2013. Our cumulative investment in these subsidiaries was \$24.0 million as of December 31, 2013, consisting of \$17.0 million in operating expenses and \$7.0 million in capital expenditures. As of December 31, 2013, the Company has written off all the fixed assets of IADS. In the immediate future we intend to continue to invest in these subsidiaries at the combined rate of \$1.5 to \$2.0 million per quarter.

Our Global Operations

We provide our services using a globally distributed workforce utilizing advanced technologies which automate portions of our process and help ensure that our work product is highly accurate and consistent.

Our production facilities are ISO 27001 certified. In addition, we comply with the requirements of the United States' Health Insurance Portability and Accountability Act of 1996 as amended (HIPAA) (including by the Health Information Technology for Economic and Clinical Health Data (HITECH)) and the United Kingdom's Data Protection Act 1998 (DPA), as applicable. Both Innodata and Synodex are U.S. Safe Harbor registered entities adhering to both the European Union and the Switzerland Safe Harbor Frameworks on the protection of personal data. We encrypt all individual protected health information, both at rest and in motion, to the AES 256 or similar standard, and we employ a range of security features including monitored firewalls and intrusion detection devices.

For our data extraction services, we maintain staff in a wide spectrum of disciplines, including medicine, law, engineering, management, finance, science and the humanities.

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 and Israel.

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

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

Our Opportunity

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

Meanwhile, for enterprises that rely on content to support operations, this shift to digital technology offers opportunities to improve internal decision support and risk mitigation in complex data operations by harnessing the power of machine-readable, digital data to drive improved decision support. For enterprises that rely on content to support products, this shift to digital technology offers opportunities to create and manage content more efficiently, while at the same time distributing content through an increased number of channels.

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

Clients

Four clients each generated more than 10% of our revenues in the fiscal year ended 2013. Revenues from Apple Inc. (“Apple”) were approximately \$6.8 million, or 11% of total revenues, revenues from Bloomberg L.P. affiliated companies (the “BLP Clients”) were approximately \$9.5 million, or 15% of total revenues, revenues from Reed Elsevier affiliated companies (the “RE Clients”) were approximately \$9.6 million or 15% of total revenues, and revenues from Wolters Kluwer affiliated companies (the “WK Clients”) were approximately \$6.8 million, or 11% of total revenues. No other client generated more than 10% of our revenues in 2013. These four clients together generated approximately 51%, 57% and 51% of our total revenues in the fiscal years ended December 31, 2013, 2012 and 2011, respectively. Revenues from clients located in foreign countries (principally in Europe) accounted for 35%, 24% and 30% of our total revenues for these respective fiscal years.

We have long-standing relationships with many of our clients, and we have provided services to three of the four clients mentioned in the preceding paragraph for over ten years. Our track record of delivering high-quality services helps us to solidify client relationships. Many of our clients have continued to provide additional projects to us after our initial engagement with them.

Our contractual arrangements with Apple during calendar year 2013 consisted of a master services agreement (“MSA”) and two statements of work (“SOWs”). The MSA and SOWs automatically renew on a monthly basis unless terminated by either party for convenience on 60 days’ prior notice with respect to the MSA and one SOW, and on 30 days’ prior notice wi