

Information Services Group

Sharper Focus with Automation Sale

Oct 04, 2024

Technology

III

NASDAQ

Rating

Outperform

Unchanged

Current Price

\$3.24

Target Price

\$5.00

Market Capitalization

158.41M

Shares Outstanding

48.89M

Float

35.33M

Institutional Holdings

61.86%

12-Month Low/High

\$2.92/\$4.98

Average 90-Day Volume

90800

Fiscal Year End

12/31/2024

Sale of a Unit. Wednesday, ISG announced the sale of its non-core automation unit to UST, a digital transformation solutions company, for \$27 million. At closing, ISG received \$20 million in cash with \$4 million to be released over the next 90 days and \$3 million to be released at the end of 1Q25. Proceeds will be used for reducing debt, re-investing in the business, and returning capital to shareholders. Automation contributed roughly \$30 million of annual revenue, including \$18 million of recurring revenue.

AI Business. With large enterprises' increasing focus on AI, ISG is placing more emphasis in this area and we believe is poised to capitalize on future spending through its AI Advisory and Research segments. Early indications of growing demand are showing with ISG Tango's total contract value rising at the end of the second quarter.

Reducing Debt and Increasing Shareholder Value. The proceeds from the sale will be used for reducing the Company's debt, as management is aiming for a goal of 2.0x to 2.5x debt to EBITDA, below its long-term 2.8x average, and expects to hit 2.5x by the end of Q4. As for share repurchases, the Company still has \$20 million remaining in its share repurchase program and we believe management will be opportunistic in buying back shares.

Updating Projections. With the sale of the business unit, management updated their third quarter guidance. Management is now expecting revenue to be between \$60 million to \$61 million and adj. EBITDA of \$6.5 million to \$7 million. We estimate third quarter revenue of \$61 million from a prior \$64.5 million, net income of \$0.2 million, or flat EPS, from \$0.4 million or \$0.01/sh, and adj. EBITDA of \$7 million from \$7.3 million.

Reducing Price Target. We are maintaining our Outperform rating but reducing our 12-month price target of \$8 to \$5. At our price target, III shares would trade at 12.6x our 2024 adjusted EBITDA, and 1.3x our 2024 revenue estimate. The macroenvironment continues to be challenging with ISG's rebound being slower than expected, however we believe in the Company's growth prospects and value added capabilities.

Equity Research

Joe Gomes, CFA, Managing Director, Equity Research Analyst, Generalist
561-999-2262, jgomes@noblecapitalmarkets.com, [LinkedIn](#)

Joshua Zoepfel, Research Associate - jzoepfel@noblecapitalmarkets.com

Noble Capital Markets, Inc.

Trading: (561) 998-5489 Sales: (561) 998-5491
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Revenues (\$ MIL)

Period	2023A	2024E	2025E
Q1	78.5A	64.3A	
Q2	74.6A	64.3A	
Q3	71.8A	61.0E	
Q4	66.2A	58.0E	
	291.1A	247.5E	265.0E

EPS (\$)

Period	2023A	2024E	2025E
Q1	0.12A	(0.01)A	
Q2	0.11A	0.08A	
Q3	0.11A	0.06E	
Q4	0.06A	0.05E	
	0.40A	0.20E	0.27E

Company Profile

Information Services Group is a leading technology insights, market intelligence, and advisory services company. With clients in both the private and public sector, the company enables business and organizations to optimize their operations through research, bench-marking, consulting, and managed services with a focus on information technology, business process transformation, program management services, and enterprise resource planning.

Fundamental Analysis - 4.0/5.0 Checks

In our assessment, we give ISG 4.0 checks out of 5.0, which falls within our "Above Average" range of 3.5 to 4.0 checks. From a Corporate Governance stance, five of six directors are independent and the Company has stock ownership guidelines. We would note that Officers and Directors own 13.9% of the outstanding shares, including 8.9% by the CEO. ISG has significant long term growth opportunities from several areas of the business. The ISG management team has developed this position with a patient and effective M&A strategy over the years, and we believe has minimized execution risk. Finally, the company is financially strong, with recent debt repayments lowering the overall leverage position of the Company. There is significant opportunity to increase operating margins over time, with a goal of 17% adjusted EBITDA margin in 2025 compared to 12.9% for 2023. For further explanation of our fundamental analysis, refer to the disclosures at the end of this report.

Valuation Summary With the announcement of the sale, we are maintaining our Outperform rating but reducing our 12-month price target of \$8.00 for to \$5.00 for III shares. At our price target, III shares would trade at 12.6x our 2024 adjusted EBITDA, and 1.3x our 2024 revenue estimate. The rebound in the Company's performance is slower than anticipated given the macroenvironment; however, the Company's market analysis shows spending increasing over the 2024 fiscal year. We believe the Company's services will start to gain traction once spending increases. The sale of its automation business also reduces performance for ISG in the short term and will take some time to recoup the reduction. These multiples compare to a peer group average of 13.0x 2024 consensus EBITDA, and 1.7x 2024 consensus revenue. III shares currently trade at below the peer group for both the EV/EBITDA and revenue multiple, we believe the Company's growth prospects and value added capabilities can place the Company within its peers.

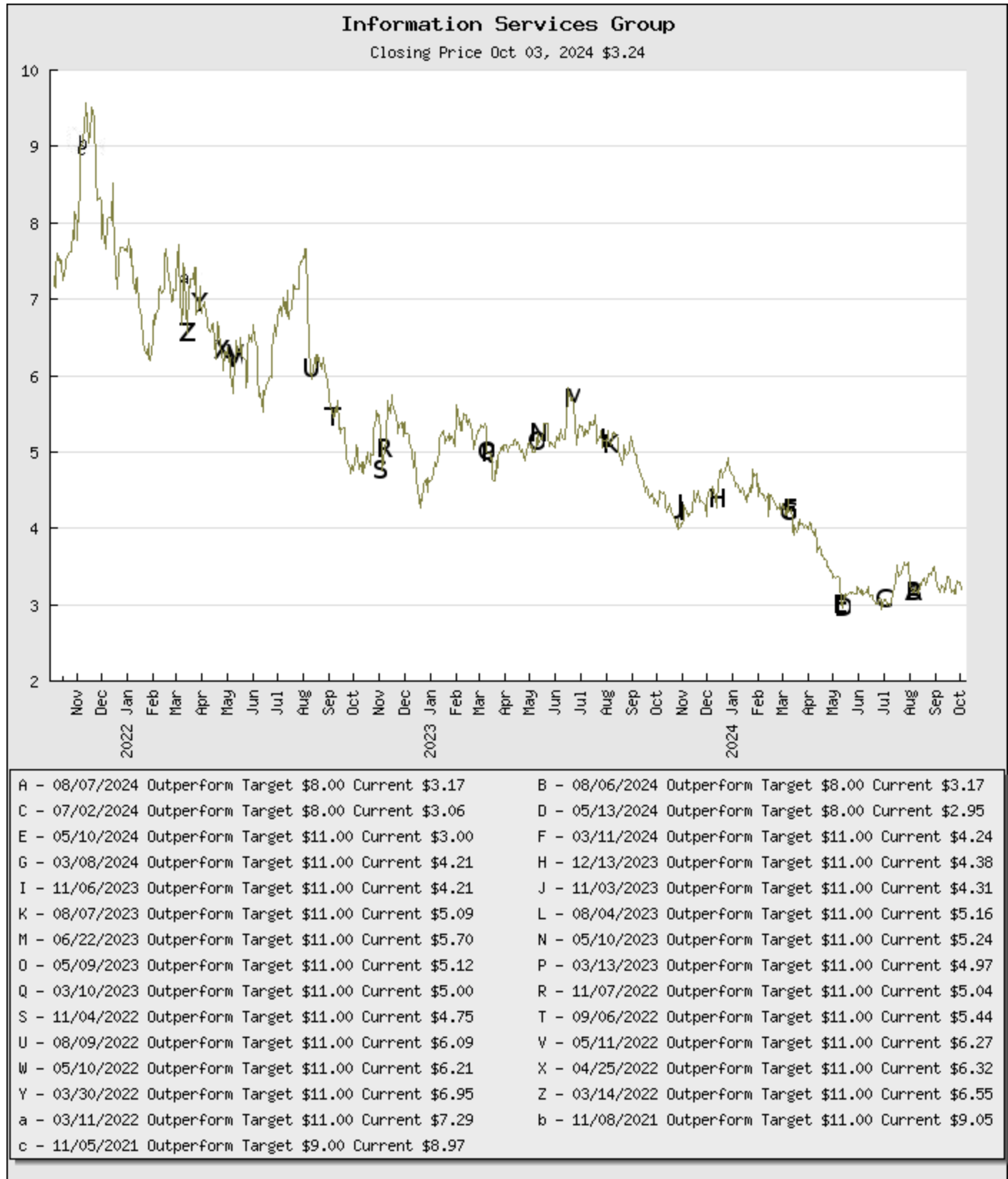
Risks in achieving our price target include: a stalled global economy, high levels of revenue concentration with its top 20 clients, high levels of foreign revenue, and its debt position.

Information Services Income Statement

Figures in Thousands, except per share amounts	FY2021 Dec-21	FY2022 Dec-22	Q1 2023 Mar-23	Q2 2023 Jun-23	Q3 2023 Sep-23	Q42023 Dec-23	FY2023 Dec-23	Q1 2024 Mar-24	Q2 2024 Jun-24	Q3 2024E Sep-24	Q42024E Dec-24	FY2024E Dec-24	FY2025E Dec-25
Revenue	277,832	286,267	78,486	74,609	71,773	66,186	291,054	64,269	64,263	61,000	58,000	247,532	265,000
Direct Costs	168,475	169,650	49,169	45,847	43,032	40,865	178,913	41,047	38,908	37,250	35,000	152,205	161,500
Gross Profit	109,357	116,617	29,317	28,762	28,741	25,321	112,141	23,222	25,355	23,750	23,000	95,327	103,500
Gross Profit Margin	39.4%	40.7%	37.4%	38.6%	40.0%	38.3%	38.5%	36.1%	39.5%	38.9%	39.7%	38.5%	39.1%
Selling, General and Admin	78,759	81,769	20,670	22,330	20,992	27,276	91,268	24,087	20,083	20,500	20,500	85,170	86,000
SGA % of Revenue	28.3%	28.6%	26.3%	29.9%	29.2%	41.2%	31.4%	37.5%	31.3%	33.6%	35.3%	34.4%	32.5%
Depreciation and Amortization	5,331	5,369	1,597	1,569	1,526	1,567	6,259	1,505	1,622	1,600	1,600	6,327	6,500
Operating Income	25,267	29,479	7,050	4,863	6,223	(3,522)	14,614	(2,370)	3,650	1,650	900	3,830	11,000
Operating Profit Margin	9.1%	10.3%	9.0%	6.5%	8.7%	-5.3%	5.0%	-3.7%	5.7%	2.7%	1.6%	1.5%	4.2%
Interest Expense, net	2,199	3,031	1,736	1,310	1,429	1,301	5,776	1,243	1,346	1,300	1,100	4,989	4,000
Other Expense (Income), net	-	(234)	110	(156)	2	118	74	7	(13)	-	-	(6)	-
Income Before Taxes	23,068	26,682	5,204	3,709	4,792	(4,941)	8,764	(3,620)	2,317	350	(200)	(1,153)	7,000
Pretax Margin	8.3%	9.3%	6.6%	5.0%	6.7%	-7.5%	3.0%	-5.6%	3.6%	0.6%	-0.3%	-0.5%	2.6%
Income Taxes	7,582	6,956	1,713	1,376	1,591	(2,072)	2,608	(231)	279	105	(285)	(132)	1,950
Income Tax Rate	32.9%	26.1%	32.9%	37.1%	33.2%	41.9%	29.8%	6.4%	12.0%	30.0%	142.5%	11.4%	27.9%
Net Income	15,486	19,726	3,491	2,333	3,201	(2,869)	6,156	(3,389)	2,038	245	85	(1,021)	5,050
Noncontrolling Interest	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income for ISG	15,486	19,726	3,491	2,333	3,201	(2,869)	6,156	(3,389)	2,038	245	85	(1,021)	5,050
Diluted Shares	51,750	50,420	50,288	50,317	50,257	49,838	50,175	48,492	49,577	49,550	49,000	49,155	48,000
Diluted GAAP EPS	\$0.30	\$0.39	\$0.07	\$0.05	\$0.06	(\$0.06)	\$0.12	(\$0.07)	\$0.04	\$0.00	\$0.00	(\$0.02)	\$0.11
EBITDA	FY 2021	FY 2022	Q1 2023	Q2 2023	Q3 2023	Q42023	FY 2023	Q1 2024	Q2 2024	Q3 2024E	Q42024E	FY 2024	FY 2025E
Operating Income	25,267	29,479	7,050	4,863	6,223	(3,522)	14,614	(2,370)	3,650	1,650	900	3,830	11,000
Depreciation and Amortization	5,331	5,369	1,597	1,569	1,526	1,567	6,259	1,505	1,622	1,600	1,600	6,327	6,500
EBITDA	30,598	34,848	8,647	6,432	7,749	(1,955)	20,873	(865)	5,272	3,250	2,500	10,157	17,500
EBITDA Margin	11.0%	12.2%	11.0%	8.6%	10.8%	-3.0%	7.2%	-1.3%	8.2%	5.3%	4.3%	4.1%	6.6%
Stock Based Compensation	6,467	7,460	2,042	2,612	2,098	2,380	9,132	2,249	1,112	2,250	2,250	7,861	8,000
Other Adjustments	1,747	948	291	1,102	799	5,482	7,674	3,030	729	1,500	1,250	6,509	3,000
Adjusted EBITDA	38,812	43,256	10,980	10,146	10,646	5,907	37,679	4,414	7,113	7,000	6,000	24,527	28,500
Adjusted EBITDA Margin	14.0%	15.1%	14.0%	13.6%	14.8%	8.9%	12.9%	6.9%	11.1%	11.5%	10.3%	9.9%	10.8%
Adjusted Earnings	FY 2021	FY 2022	Q1 2023	Q2 2023	Q3 2023	Q42023	FY 2023	Q1 2024	Q2 2024	Q3 2024E	Q42024E	FY 2024	FY 2025E
Net Income	15,486	19,726	3,491	2,333	3,201	(2,869)	6,156	(3,389)	2,038	245	85	(1,021)	5,050
Intangible Amortization	2,643	2,323	794	789	769	812	3,164	755	738	735	735	2,963	3,000
Stock Compensation and Other	7,940	8,408	2,712	3,714	2,899	2,380	11,705	5,279	1,828	2,250	2,250	11,607	9,000
Foreign Currency Transaction	230	(171)	194	(156)	-	5,565	5,603	7	-	-	-	7	-
Tax effect	(3,459)	(3,378)	(1,184)	(1,391)	(1,174)	(2,802)	(6,551)	(1,933)	(821)	(500)	(500)	(3,754)	(4,000)
Adjusted Net Income	22,840	26,908	6,007	5,289	5,695	3,086	20,077	719	3,783	2,730	2,570	9,802	13,050
Diluted Adjusted EPS	\$0.44	\$0.53	\$0.12	\$0.11	\$0.11	\$0.06	\$0.40	\$0.01	\$0.08	\$0.06	\$0.05	\$0.20	\$0.27
Adjusted Earnings Margin	8.2%	9.4%	7.7%	7.1%	7.9%	4.7%	6.9%	1.1%	5.9%	4.5%	4.4%	4.0%	4.9%

Source: Company Reports and Noble Capital Markets Estimates

Note: Red represents forward looking estimates



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The fundamental assessment rating system is designed to provide insights on the company's fundamentals both on a macro level, which incorporates a company's market opportunity and competitive position, and on a micro/company specific level. The micro/company specific attributes include operating & financial leverage, and corporate governance/management. The number of check marks that a company receives is designed to provide a quick reference and easy determination of the company's fundamentals based upon the following five attributes of the company (weighting reflects the importance of each attribute in the overall scoring of company's fundamental analysis):

Attribute	Weighting
Corporate Governance/Management	20%
Market Opportunity Analysis	20%
Competitive Position	20%
Operating Leverage	20%
Financial Leverage	20%

For each attribute, the analysts score the company from a low of zero to a high of ten based upon the analysis described below. The final rating and resulting check marks is a result of dividing the overall score (out of 100%) by ten.

Rating	Score	Checks
Superior	9.1 to 10	Five Checks
Superior	8.1 to 9	Four & A Half Checks
Above Average	7.1 to 8	Four Checks
Above Average	6.1 to 7	Three & A Half Checks
Average	5.1 to 6	Three Checks
Average	4 to 5	Two & A Half Checks
Below Average	3 to 3.9	Two Checks
Below Average	2 to 2.9	One & A Half Checks
Low Quality	0 to 1.9	One Check

While these are the attributes currently used for the analyst's fundamental analysis, the attributes and weighting may be reviewed, updated with additional attributes, and/or changed in the future based on discussions with the analysts and recommendations from the Director of Research.

Following is the description of each attribute in the fundamental analysis.

Corporate Governance/Management

We believe that a review of corporate governance and assessment of the senior management are important tools to determine investment merit. Good corporate governance aligns management with the interests of stakeholders. As such, analysts are to rank the company on the basis of good corporate governance principles that may include rules and procedures, board composition and staggered term limits, rights and responsibilities, corporate objectives, monitoring of actions and policies, and accountability. In addition, analysts will assess issues with controlling shareholders and whether decisions have been made in the past that were in the interests of all shareholders. In addition, management will be assessed based on industry experience, expertise, and/or track record.

High ranking example: Board and management that is aligned with the interests of shareholders with incentives based on stock price appreciation and with an experienced management team known for exceptional shareholder returns.

Low ranking example: Concentrated ownership without independent directors that do not necessarily align with all shareholders' interests.

The Market Opportunity Analysis

In this review, the analyst assesses the company's macro environment as a measure of understanding the industry. Factors considered include the size and growth potential of the industry under various economic conditions, the emerging demands in the market, technological benefits/disruptions, competition, geographical opportunities, and customer demands/needs, and an assessment of supply and distribution channels. In addition, the analyst will review legal and regulatory trends, as well as potential shifts in consumer or social behavior and natural environment changes.

High rank example: A company in an industry that is growing revenues well above GDP rates (which are on average 2% plus) and/or may have unmet or underserved needs in a rapidly growing market opportunity.

Low rank example: A mature industry that is in secular decline and likely to grow below GDP rates.

Competitive Position

The evaluation of the company's competitive position is another macro environment attribute designed to measure the relevance, market share, position and value proposition, and sustainable differentiations of the company and its products/services within its industry. Ease of entry into the industry and the ability of other well-funded players to potentially enter the market would be determined. As such, the assessment would consider the company's strengths and advantages of its products/services against weaknesses and limitations. This may include the company's current brand awareness, pricing and cost structure, current market strategies and geographic penetration that may affect demand for its products/services. In addition, the company's competitors would be evaluated.

High rank example: An analyst would consider the company's product to be superior to its competitors and that should allow the company to gain market share.

Low rank example: A company with a "me-too" product that does not have any significant technology advantages in an industry that has low barriers to entry.

Operating Leverage

Simplistically, operating leverage is determined by the operating income relative to changes in revenue. The analyst will calculate the impact on sensitivity on gross margins and variable costs to determine operating leverage. The analyst will take into account the ability of the company to cut fixed and variable costs in a challenged revenue environment and technological changes that may impact operating expenses. In addition, the analyst is to assess corporate strategies that include capital investment, which may be required for sustainable revenue growth, marketing expenses, and the company's ability to attract and retain talent and/or employees. The analyst should focus on the revenue opportunity and determine the price elasticity of demand for the company's products or services. In other words, the analyst is to rank the company based on improved operating margins going forward on an absolute and relative basis.

High rank example: A company that has improving margins for the foreseeable future, with significant price elasticity.

Low rank example: A company that is in a challenged revenue environment with a fixed cost structure and limited ability to cut costs, indicating an outlook for declining margins.

Financial Leverage

A strict definition of financial leverage is total debt divided by total shareholder's equity. Financial leverage analysis is to determine the company's ability to improve shareholder value by means of utilizing its balance sheet to grow organically or to acquire assets. Analysts may look at the company's debt to cash flow leverage ratio, interest coverage ratios, or debt to equity ratios. In addition, the interest rate environment and the outlook for interest rates are a factor in determining the company's ability to manage financial leverage. Finally, the analyst is expected to determine the ability to service the debt given the industry and/or company profile, such as cyclical, barriers to entry, history of bankruptcy, consistency in revenue and profit growth, or predictability in sales and profits and large cash reserves. The analyst is expected to take into account capital intensity of the company and the anticipated of capital allocation decisions.

High rank example: A company with predictable and growing revenue and cash flow with modest debt levels. This may indicate that the company could improve shareholder value through growth investments, including acquisitions, using debt financing.

Low rank example: A company in a cyclical industry in a late stage economic cycle that has above average debt leverage and is in an industry that has a history of financial challenges, including bankruptcies.

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NOBLE RATINGS DEFINITIONS	% OF SECURITIES COVERED	% IB CLIENTS
Outperform: potential return is >15% above the current price	90%	25%
Market Perform: potential return is -15% to 15% of the current price	10%	3%
Underperform: potential return is >15% below the current price	0%	0%

NOTE: On August 20, 2018, Noble Capital Markets, Inc. changed the terminology of its ratings (as shown above) from "Buy" to "Outperform", from "Hold" to "Market Perform" and from "Sell" to "Underperform." The percentage relationships, as compared to current price (definitions), have remained the same.

Additional information is available upon request. Any recipient of this report that wishes further information regarding the subject company or the disclosure information mentioned herein, should contact Noble Capital Markets, Inc. by mail or phone.

Noble Capital Markets, Inc.
 150 E Palmetto Park Rd, Suite 110
 Boca Raton, FL 33432
 561-994-1191

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