COVALENT GROUP INC
Form 10-Q
August 12, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2005.

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: 0-21145

COVALENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**56-1668867**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

One Glenhardie Corporate Center, 1275 Drummers Lane, Suite 100, Wayne, Pennsylvania 19087

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: 610-975-9533

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 x No ¨.

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act). Yes ¨ No x.

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: As of July 29, 2005, there were 13,501,333 shares of Covalent Group, Inc. common stock outstanding, par value $.001 per share, excluding 152,932 shares in treasury.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Covalent Group, Inc.

Consolidated Condensed Balance Sheets

	June 30, 2005	December 31, 2004
Assets		
Current Assets		
Cash and cash equivalents	$ 4,765,827	$ 3,165,986
Restricted cash	142,970	145,612
Accounts receivable, less allowance of $35,093 and $40,000 at June 30, 2005 and December 31, 2004, respectively	4,019,358	5,209,950
Prepaid expenses and other	294,786	158,287
Prepaid taxes	1,049,076	1,132,315
Costs and estimated earnings in excess of related billings on uncompleted contracts	687,915	1,667,947
Total Current Assets	10,959,932	11,480,097
Property and Equipment, Net	1,097,998	1,321,139
Other Assets	21,665	21,665
Total Assets	$ 12,079,595	$ 12,822,901
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 524,345	$ 1,101,788
Accrued expenses	144,229	392,385
Obligations under capital leases	24,977	23,709
Billings in excess of related costs and estimated earnings on uncompleted contracts	2,413,861	1,770,275
Customer advances	1,175,692	1,080,469
Total Current Liabilities	4,283,104	4,368,626
Long Term Liabilities		
Obligations under capital leases	50,495	63,309
Other liabilities	523,539	581,710
Total Long Term Liabilities	574,034	645,019
Total Liabilities	4,857,138	5,013,645
Stockholders Equity		

Common stock, $.001 par value 25,000,000 shares authorized, 13,501,201 and 13,495,534 shares issued and outstanding respectively	13,502	13,496
Additional paid-in capital	12,028,496	12,017,822
Accumulated deficit	(4,514,922)	(3,933,377)
Accumulated other comprehensive income	154,355	170,289
Less:	7,681,431	8,268,230
Treasury stock, at cost, 152,932 shares	(458,974)	(458,974)
Total Stockholders Equity	7,222,457	7,809,256
Total Liabilities and Stockholders Equity	$ 12,079,595	$ 12,822,901

See accompanying notes to the consolidated condensed financial statements.

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Covalent Group, Inc.

Consolidated Condensed Statements of Operations

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Net revenue	$ 2,328,379	$ 3,778,774	$ 5,541,908	$ 9,061,359
Reimbursement revenue	328,554	2,618,378	1,002,826	4,258,511
Total Revenue	2,656,933	6,397,152	6,544,734	13,319,870
Operating Expenses				
Direct	1,744,915	4,002,847	3,787,683	7,678,427
Reimbursement out-of-pocket expenses	328,554	2,618,378	1,002,826	4,258,511
Selling, general and administrative	952,954	1,547,032	2,099,293	2,870,492
Depreciation and amortization	132,232	180,095	269,757	433,975
Total Operating Expenses	3,158,655	8,348,352	7,159,559	15,241,405
Loss from Operations	(501,722)	(1,951,200)	(614,825)	(1,921,535)
Interest Income	21,253	926	38,361	1,683
Interest Expense	(2,605)	(2,656)	(5,082)	(5,484)
Net Interest Income (Expense)	18,648	(1,730)	33,279	(3,801)
Loss before Income Taxes	(483,074)	(1,952,930)	(581,546)	(1,925,336)
Income Tax Benefit		(506,200)		(505,711)
Net Loss	$ (483,074)	$ (1,446,730)	$ (581,546)	$ (1,419,625)
Net Loss per Common Share				
Basic	$ (0.04)	$ (0.11)	$ (0.04)	$ (0.11)
Diluted	$ (0.04)	$ (0.11)	$ (0.04)	$ (0.11)
Weighted Average Common and Common Equivalent Shares Outstanding				
Basic	13,348,441	13,213,297	13,345,521	13,147,924
Diluted	13,348,441	13,213,297	13,345,521	13,147,924

See accompanying notes to the consolidated condensed financial statements.

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Covalent Group, Inc.

Consolidated Condensed Statements of Cash Flows

	Six Months Ended June 30,	
	2005	**2004**
Operating Activities:		
Net loss	$ (581,546)	$ (1,419,625)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	269,757	433,975
Changes in assets and liabilities;		
Restricted cash	2,642	(278,498)
Accounts receivable	1,190,592	511,119
Prepaid expenses and other	(136,499)	(115,544)
Prepaid Taxes	83,239	(270,943)
Costs and estimated earnings in excess of related billings on uncompleted contracts	980,032	3,314,396
Accounts payable	(577,442)	475,644
Accrued expenses	(248,156)	106,710
Other Liabilities	(58,171)	(58,170)
Billings in excess of related costs and estimated earnings on uncompleted contracts	643,586	(44,276)
Customer advances	95,223	(1,036,797)
Net Cash Provided by Operating Activities	1,663,257	1,617,991
Investing Activities:		
Purchases of property and equipment	(46,616)	(82,151)
Net Cash Used In Investing Activities	(46,616)	(82,151)
Financing Activities:		
Repayments under capital leases	(11,546)	(13,310)
Proceeds from exercise of stock options	10,680	607,829
Net Cash Provided (Used) By Financing Activities	(866)	594,519
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(15,934)	26,360
Net Increase In Cash and Cash Equivalents	1,599,841	2,159,719
Cash and Cash Equivalents, Beginning of Period	3,165,986	2,069,687
Cash and Cash Equivalents, End of Period	$ 4,765,827	$ 4,226,406

See accompanying notes to the consolidated condensed financial statements.

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Covalent Group, Inc.

Notes to Consolidated Condensed Financial Statements

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

The accompanying unaudited financial statements for the three and six months ended June 30, 2005 and June 30, 2004 have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (primarily consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2005 may not necessarily be indicative of the results that may be expected for other quarters or for the year ending December 31, 2005. For further information, refer to the financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2004.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Consolidation

The consolidated financial statements as of June 30, 2005 and December 31, 2004 and for the three and six months ended June 30, 2005 and 2004 include our accounts and the accounts of our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Restricted Cash

We received advance payments from one of our clients as part of a long-term contract, which included a separate restricted cash account to be utilized for payment of investigator fees. As of June 30, 2005 and December 31, 2004, this restricted cash amount was $143 thousand and $146 thousand, respectively. This amount is also included in customer advances in the accompanying balance sheets.

Accounts Receivable

Accounts receivable, net of an allowance for doubtful accounts, consists of customer billings pursuant to contractual terms related to work performed as of June 30, 2005. In general, amounts become billable upon the achievement of milestones or in accordance with predetermined payment schedules set forth in the contracts with our clients. A portion of the balance represents amounts billed subsequently to the balance sheet date. Accounts receivable included $3.5 million and $4.9 million billed to customers as of June 30, 2005 and December 31, 2004, respectively, and $500 thousand and $300 thousand that was billable to clients pursuant to contractual terms and invoiced subsequent to June 30, 2005 and December 31, 2004, respectively.

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Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a small number of companies within the pharmaceutical, biotechnology and medical device industries. The significant majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of June 30, 2005, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $4.7 million. Of this amount, the exposure to our three largest clients was 79% of the total, with the three largest clients representing 45%, 20%, and 14% of total exposure, respectively. As of June 30, 2004, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $10.6 million. Of this amount, the exposure to our three largest clients was 66% of the total, with the three largest clients representing 36%, 21%, and 9% of total exposure, respectively.

Revenue Recognition

The majority of our net revenue is recognized from fixed-price contracts on a proportional performance basis. To measure the performance, we compare actual direct costs incurred to estimated total contract direct costs, which we believe is the best indicator of the performance of the contract obligations as the costs relate to the labor hours incurred to perform the service. Total direct costs are incurred for each contract and compared to estimated total direct costs for each contract to determine the percentage of the contract that is completed. This percentage is multiplied by the estimated total contract value to determine the amount of net revenue recognized. A formal project review process takes place quarterly although most projects are evaluated on an ongoing basis. Management reviews the estimated total direct costs on each contract to determine if estimated amounts are correct and estimates are adjusted as needed. If we determine that a loss will result from the performance of a fixed-price contract, the entire amount of the estimated loss is charged against income in the period in which such determination is made. Because of the inherent uncertainties in estimating direct costs required to complete a project, particularly complex, multi-year studies, it is possible that the estimates used will change and could result in a material change to our estimates of contract profitability. Original estimates might also be changed due to changes in the scope of work. We attempt to negotiate contract amendments with the client to cover these services provided outside the terms of the original contract. There can be no assurance that the client will agree to the proposed amendments, and we ultimately bear the risk of cost overruns. For terminated studies, our contracts frequently entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination.

Costs and estimated earnings in excess of related billings on uncompleted contracts represent net revenue recognized to date that is currently unbillable to the client pursuant to contractual terms. In general, amounts become billable upon the achievement of milestones or in accordance with predetermined payment schedules set forth in the contracts with our clients. Several of our older contracts contain payment schedules that are weighted towards the later stages of the contract. Billings in excess of related costs and estimated earnings on uncompleted contracts represent amounts billed in excess of net revenue recognized at the balance sheet date.

Reimbursable Out-of-Pocket Expenses

On behalf of our clients, we pay fees to investigators and other out-of-pocket costs for which we are reimbursed at cost, without mark-up or profit. Effective January 1, 2002, in connection with the required implementation of Financial Accounting Standards Board (FASB) Emerging Issues Task Force Rule No. 01-14 (EITF 01-14), Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred , out-of-pocket costs are now included in Operating Expenses, while the reimbursements received are reported separately as Reimbursement Revenue in the Consolidated Statements of Operations.

As is customary in the industry, we exclude from revenue and expense in the Consolidated Statements of Operations fees paid to investigators and the associated reimbursement since we act as an agent on behalf

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of our clients with regard to investigators. These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of these investigator fees were $267 thousand and $1.1 million for the three and six months ended June 30, 2005, respectively. For the three and six months ended June 30, 2004, investigator fees were $1.6 million and $2.7 million, respectively.

Stock Based Compensation

We have adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants. We account for grants of options to employees and directors under these plans applying the intrinsic value method provided for in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. No stock-based compensation expense is reflected in net income as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. In addition to APB Opinion No. 25, we provide the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation and by SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation to stock-based employee compensation:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net Loss - as reported	$ (483,074)	$ (1,446,730)	$ (581,546)	$ (1,419,625)
Deduct: Pro forma stock-based compensation expense determined under the fair value method	(59,341)	(51,256)	(111,140)	(103,817)
Pro forma Net Loss	$ (542,415)	$ (1,497,986)	$ (692,686)	$ (1,523,442)
Net Loss Per Share				
Basic - as reported	$ (0.04)	$ (0.11)	$ (0.04)	$ (0.11)
Basic - pro forma	$ (0.04)	$ (0.11)	$ (0.05)	$ (0.12)
Diluted - as reported	$ (0.04)	$ (0.11)	$ (0.04)	$ (0.11)
Diluted - pro forma	$ (0.04)	$ (0.11)	$ (0.05)	$ (0.12)

For purposes of determining the pro forma amounts, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Risk-free interest rate	3.63% - 4.12%	3.58% - 3.91%	3.63% - 4.17%	2.85% - 3.91%

Expected dividend yield				
Expected life	5 years	5 years	5 years	5 years
Expected volatility	55%	47%	55%	47%

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Based upon the above assumptions, the weighted average fair value of the stock options granted for the three and six months ended June 30, 2005 was $1.13 and $1.16, respectively. For the three and six months ended June 30, 2004 the weighted average fair value of the stock options granted was $1.75 and $1.17, respectively. Because additional option grants are expected to be made, the above pro forma disclosures are not representative of pro forma effects on reported net income for future periods.

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

2. RECENTLY ISSUED ACCOUNTING STANDARDS:

In December 2004, the FASB issued SFAS No. 123 (R), Share Based Payment. Statement No. 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share based payments granted to employees. This statement is effective for the first fiscal year beginning after June 15, 2005. The Company will adopt Statement No. 123 (R) beginning with the first quarter of fiscal 2006. Adoption of the statement will require the Company to record compensation expense relating to the issuance of employee stock options. Currently, the Company follows APB No. 25 which does not require the recognition of compensation expense relating to the issuance of stock options so long as the quoted market price of our stock at the date of grant is less than or equal to the amount an employee must pay to acquire the stock. We are currently evaluating the impact the adoption of this statement will have on its consolidated financial position and results of operations.

3. EARNINGS PER SHARE

Earnings per share is calculated in accordance with SFAS No. 128, Earnings Per Share. Basic earnings per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares plus the dilutive effect of outstanding stock options under our equity incentive plans. Stock options outstanding that are not included in the table below because of their anti-dilutive effect for the three and six months ended June 30, 2005 were 591,763 and 566,680 respectively. Stock options outstanding that are not included in the table below because of their anti-dilutive effect for the three and six months ended June 30, 2004 were 600,500 and 600,900 respectively.

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The net loss and weighted average common and common equivalent shares outstanding for purposes of calculating net loss per common share were computed as follows:

Net Loss Per Common Share & Common Equivalent Share

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net Loss	$ (483,074)	$ (1,446,730)	$ (581,546)	$ (1,419,625)
Weighted average number of common shares outstanding used in computuing basic earnings per share	13,348,441	13,213,297	13,345,521	13,147,924
Dilutive effect of stock options outstanding				
Weighted average shares used in computing diluted earnings per share	13,348,441	13,213,297	13,345,521	13,147,924
Basic & Diluted loss per share	$ (0.04)	$ (0.11)	$ (0.04)	$ (0.11)

4. COMPREHENSIVE INCOME

A reconciliation of comprehensive income in accordance with SFAS No. 130, Reporting Comprehensive Income is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net Loss	$ (483,074)	$ (1,446,730)	$ (581,546)	$ (1,419,625)
Foreign currency translation adjustment	(10,571)	(9,074)	(15,934)	26,360
Comprehensive Loss	$ (493,645)	$ (1,455,804)	$ (597,480)	$ (1,393,265)

5. SEGMENT INFORMATION

The Company has adopted the provisions of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information which establishes standards for reporting business segment information. The Company operates predominantly in the clinical research industry providing a broad range of clinical research services on a global basis to the pharmaceutical, biotechnology and medical device industries.

The following table summarizes the distribution of net revenue and contracts with significant clients:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005		2004		2005		2004	
	% of Revenues	Number of Contracts	% of Revenues	Number of Contracts	% of Revenues	Number of Contracts	% of Revenues	Number of Contracts
Client A	38%	2	32%	3	32%	4	28%	3
Client B	28%	3	17%	1	19%	3	14%	1
Client C	16%	5	17%	1	17%	7	11%	2
Client D			11%	1	10%	3		
Client E					10%	1		
Top Clients	82%	10	77%	6	88%	18	53%	6

Client A, B, C, D and E in the table above represent the largest clients for each period, but do not represent the same client for each year shown.

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The following table summarizes the distribution of net revenues from external clients by geographical area:

Three Months Ended June 30,					
2005			2004		
U.S	Europe	Total	U.S	Europe	Total
$ 2,226,463	$ 101,916	$ 2,328,379	$ 3,692,450	$ 86,324	$ 3,778,774

Six Months Ended June 30,					
2005			2004		
U.S	Europe	Total	U.S	Europe	Total
$ 5,094,257	$ 447,651	$ 5,541,908	$ 8,448,494	$ 612,866	$ 9,061,359

6. LINE OF CREDIT

We previously maintained a demand line of credit with a bank under which maximum borrowings were the lesser of $2.5 million or 75% of eligible accounts receivable, as defined in the loan agreement, and interest was charged at the LIBOR Market Index Rate plus 2.65%. This line of credit expired on August 15, 2004. The Company does not currently anticipate that it will be able to replace this credit facility based on its recent operating results.

7. OTHER LIABILITIES

As of January 1, 2003, the Company increased by approximately 12,700 to 34,000 the amount of square feet under lease in the same building. The term of the lease was also extended to 2010 and monthly lease payments increased from $50 thousand to $72 thousand. As an incentive for the Company to acquire the additional space, the lessor granted the Company $814 thousand in lease incentives that were used to pay for architectural fees, renovations and improvement costs for the new space. The lease incentives were capitalized as if the Company incurred the costs to make the improvements and are included in Property and Equipment. These assets and the related liability are amortized over the remaining life of the lease at a rate of approximately $116 thousand per year as an additional amortization expense and a reduction in rent expense, respectively. The accounting for these lease incentives has no impact on net income, stockholders equity or cash flow.

8. SUPPLEMENTAL CASH FLOW INFORMATION

No income tax payments were required for the three and six months ended June 30, 2005. For the three and six months ended June 30, 2004, cash paid for income taxes was approximately $254 thousand and $262 thousand, respectively. Cash paid for interest for the three and six months ended June 30, 2005 was approximately $3 thousand and $5 thousand, respectively. We did not enter into any capital lease obligations during the three and six months ended June 30, 2005 or June 30, 2004. We did not acquire any property and equipment through leasing arrangements during the three months and six months ended June 30, 2005 and ended June 30, 2004.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this discussion, the terms Company, we, us and our refer to Covalent Group, Inc. and our consolidated subsidiaries, except where it is made clear otherwise.

Forward Looking Statements

When used in this Report on Form 10-Q and in other public statements, both oral and written, by the Company and Company officers, the words estimate, project, expect, intend, believe, anticipate and similar expressions are intended to identify forward-looking statements regarding and trends that may affect our future operating results and financial position. Such statements are subject to risks and uncertainties that could cause our actual results and financial position to differ materially. Such factors include, among others: (i) our success in attracting new business and retaining existing clients and projects; (ii) the size, duration and timing of clinical trials we are currently managing may change unexpectedly; (iii) the termination, delay or cancellation of clinical trials we are currently managing could cause revenues to decline unexpectedly; (iv) the timing difference between our receipt of contract milestone or scheduled payments and our incurring costs to manage these trials; (v) outsourcing trends in the pharmaceutical, biotechnology and medical device industries; (vi) our ability to maintain profit margins in a competitive marketplace; (vii) our ability to attract and retain qualified personnel; (viii) the sensitivity of our business to general economic conditions; (ix) other economic, competitive, governmental and technological factors affecting our operations, markets, products, services and prices; (x) announced awards received from existing and potential customers are not definitive until fully negotiated contracts are executed by the parties; and (xi) our backlog may not be indicative of future results and may not generate the revenues expected. We undertake no obligation to publicly release the result of any revision of these forward-looking statements to reflect events or circumstances after the date they are made or to reflect the occurrence of unanticipated events. Please refer to the section entitled Risk Factors that Might Affect our Business or Stock Price beginning on page 9 on our annual report on Form 10-K for the year ended December 31, 2004 for a more complete discussion of factors which could cause our actual results and financial position to change.

Overview

We are a clinical research organization (CRO) which we believe is a leader in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. Our mission is to provide our clients with high quality, full-service support for their clinical trials. We offer therapeutic expertise, experienced clinical trial management and advanced technologies. Our headquarters is in Wayne, Pennsylvania and our international operations are based in Guildford, Surrey, United Kingdom.

Our clients consist of many of the largest companies in the pharmaceutical, biotechnology and medical device industries. From protocol design and clinical program development, to proven patient recruitment, to managing the regulatory approval process, we have the resources to directly implement or manage Phase I through Phase IV clinical trials and to deliver clinical programs on time and within budget. We have clinical trial experience across a wide variety of therapeutic areas, such as cardiovascular, nephrology, endocrinology/metabolism, diabetes, neurology, immunology, vaccines, infectious diseases, gastroenterology, dermatology, hepatology, womens health and respiratory medicine. We have the capacity and expertise to conduct clinical trials on a global basis.

General

The information set forth and discussed below for the three and six months ended June 30, 2005 and 2004 is derived from the Consolidated Condensed Financial Statements included elsewhere herein. The financial information set forth and discussed below is unaudited but, in the opinion of management, reflects all adjustments (primarily consisting of normal recurring adjustments) necessary for a fair presentation of such information. The results of our operations for a particular quarter may not be indicative of results expected during the other quarters or for the entire year.

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Our quarterly results can fluctuate as a result of a number of factors, including our success in attracting new business, the size and duration of clinical trials, the timing of client decisions to conduct new clinical trials or to cancel or delay ongoing trials, changes in cost estimates to complete ongoing trials, and other factors, many of which are beyond our control.

Net revenue is derived principally from the design, management and monitoring of clinical research studies. Clinical research service contracts generally have terms ranging from several months to several years. A portion of the contract fee is generally payable upon execution of the contract, with the balance payable in installments over the life of the contract. The majority of our net revenue is recognized from fixed-price contracts on a proportional performance basis. To measure the performance, we compare actual direct costs incurred to estimated total contract direct costs, which we believe is the best indicator of the performance of the contract obligations as the costs relate to the labor hours incurred to perform the service. Total direct costs are incurred for each contract and compared to estimated total direct costs for each contract to determine the percentage of the contract that is completed. This percentage is multiplied by the estimated total contract value to determine the amount of net revenue recognized.

Contracts generally may be terminated by clients immediately or with short notice. Clinical trials may be terminated or delayed for several reasons, including, among others, unexpected results or adverse patient reactions to the drug, inadequate patient enrollment or investigator recruitment, manufacturing problems resulting in shortages of the drug or decisions by the client to de-emphasize or terminate a particular trial or development efforts on a particular drug. Depending on the size of the trial in question, a client s decision to terminate or delay a trial in which we participate could have a material and adverse effect on our backlog, future revenue and results from operations.

Our backlog was approximately $20 million as of June 30, 2005 as compared to $19 million as of June 30, 2004. Our backlog consists of anticipated net revenue from signed contracts, letters of intent and certain verbal commitments that either have not started but are anticipated to begin in the near future or are in process and have not yet been completed. Many of our studies and projects are performed over an extended period of time, which may be several years. Amounts included in backlog have not yet been recognized as net revenue in our Consolidated Statements of Operations. Once contracted work begins, net revenue is recognized over the life of the contract on a proportional performance basis. The recognition of net revenue and contract terminations, if any, reduces our backlog while the awarding of new business increases our backlog. For the six months ended June 30, 2005 we obtained approximately $10.7 million of new business awards as compared to approximately $18.9 million for the six months ended June 30, 2004.

We believe that our backlog as of any date may not necessarily be a meaningful predictor of future results because backlog can be affected by a number of factors including the size and duration of contracts, many of which are performed over several years. Additionally, contracts relating to our clinical trial business may be subject to early termination by the client or delay for many reasons, as described above. Also, the scope of a contract can change during the course of a study. For these reasons, we might not be able to fully realize our entire backlog as net revenue.

The following table sets forth amounts for certain items in our consolidated statements of operations expressed as a percentage of net revenue. The following table excludes revenue and costs related to reimbursable out-of-pocket expenses because they are not generated by the services we provide, do not yield any gross profit to us, and do not have any impact on our net income. We believe this information is useful to our investors because it presents the net revenue and expenses that are directly attributable to the services we provide to our clients and provides a more accurate picture of our operating results and margins.

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Percentage of Net Revenue, Excluding Reimbursable Out-of-Pocket Expenses

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net revenue	100.0%	100.0%	100.0%	100.0%
Operating Expenses				
Direct	74.9%	105.9%	68.3%	84.7%
Selling, general and administrative	40.9%	40.9%	37.9%	31.7%
Depreciation and amortization	5.7%	4.8%	4.9%	4.8%
Loss from Operations	-21.6%	-51.7%	-11.1%	-21.2%
Net Loss	-20.7%	-38.3%	-10.5%	-15.7%

Contractual Obligations and Commitments

We did not enter into any capital lease obligations during the three and six months ended June 30, 2005 and 2004. We are committed under a number of non-cancelable operating leases, primarily related to office space and other office equipment.

Below is a summary of our future payment commitments by year under contractual obligations. Actual amounts paid under these agreements could be higher or lower than the amounts shown below as a result of changes in volume and other variables:

	2005	2006	2007	2008	2009	Thereafter	Total
Obligations under capital leases	$ 23,709	$ 26,314	$ 29,204	$ 7,791	$	$	$ 87,018
Operating Leases	960,171	921,018	937,259	952,728	969,741	986,754	5,727,671
Employment agreements	325,000	81,250					406,250
Service agreements	1,418,609	109,840	65,120	55,432	33,479	99,319	1,781,799
Total	$ 2,727,489	$ 1,138,422	$ 1,031,583	$ 1,015,951	$ 1,003,220	$ 1,086,073	$ 8,002,738

In 2005, we anticipate capital expenditures of approximately $100 thousand $150 thousand for leasehold improvements, software applications, workstations, personal computer equipment and related assets. A significant portion of our service agreement commitments, which are primarily comprised of investigator payments, are expected to be reimbursed under agreements with clients. There have been no material changes to the above data since December 31, 2004.

Critical Accounting Policies and Estimates

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. On an ongoing basis, management evaluates its judgments and estimates. Management bases its

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judgments and estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Management considers the following policies to be most critical in understanding the more complex judgments that are involved in preparing our consolidated financial statements and the uncertainties that could affect our results of operations and financial condition.

Revenue Recognition

The majority of our net revenue is recognized from fixed-price contracts on a proportional performance basis. To measure the performance, we compare actual direct costs incurred to estimated total contract direct costs, which we believe is the best indicator of the performance of the contract obligations as the costs relate to the labor hours incurred to perform the service. Total direct costs are incurred for each contract and compared to estimated total direct costs for each contract to determine the percentage of the contract that is completed. This percentage is multiplied by the estimated total contract value to determine the amount of net revenue recognized. A formal project review process takes place quarterly although most projects are evaluated on an ongoing basis. Management reviews the estimated total direct costs on each contract to determine if estimated amounts are correct, and estimates are adjusted as needed. If we determine that a loss will result from the performance of a fixed-price contract, the entire amount of the estimated loss is charged against income in the period in which such determination is made. Because of the inherent uncertainties in estimating direct costs required to complete a project, particularly complex, multi-year studies, it is possible that the estimates used will change and could result in a material change to our estimates of contract profitability or percentage of contract completion. Original estimates may also be revised due to changes in the scope of work. We attempt to negotiate contract amendments with the client to cover services provided outside the terms of the original contract. There can be no assurance that the client will agree to the proposed amendments, and we ultimately bear the risk of cost overruns. For terminated studies, our contracts frequently entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination.

There are no standard billing or milestone arrangements which are present in each contract. Each contract has separate and distinct billing and payment terms which are the result of a negotiation between us and the client. Accordingly, cash receipts do not necessarily correspond to costs incurred and revenue recognized on contracts. The contracts may contain provisions for renegotiation of cost overruns arising from changes in the scope of work. Renegotiated amounts are included in net revenues when earned and realization is assured.

In most instances, for multi-year contracts, a portion of the contract fee, typically 10% to 15% is paid up front at the time the contract is signed. These up front payments are deferred and recognized as revenue as services are performed under the proportional performance method. In certain instances, additional payments are received from clients based upon the achievement of performance based milestones over the duration of the contract. Examples of performance based milestones and interim deliverables include, but are not limited to, the completion of patient enrollment in to the clinical trial, completion of the database and acceptance by the client of final study report regarding data collected during the clinical trial. It should be noted that, in a comprehensive full service drug development program, the client would generally not purchase these deliverables separately but as part of an integrated, full service arrangement in connection with the development of the drug.

Contracts are subject to cancellation or delay at the option of the client. These delays or cancellations include but are not limited to client economic issues, drug safety, regulatory or efficacy issues that may arise during the term of the clinical trial. Client initiated delays or cancellations for ongoing clinical trials can come suddenly and may not be foreseeable. Most contracts are terminable either immediately or after a specified period (i.e. generally 30 days) following written notice to us by the client. To offset the effects of early terminations of significant contracts, we attempt to negotiate the payment of an early termination fee. Generally, we have not been successful in negotiating early termination fees in our agreements. Our contracts typically require

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payment to us of expenses incurred to wind down a study and fees earned to date. Therefore, revenue recognized prior to cancellation does not require a significant adjustment upon cancellation. If we determine that a loss will result from the performance of a fixed price contract, the estimated loss is charged against income in the period in which such determination is made.

Our accounting policy for recognizing revenue for terminated projects requires us to perform a reconciliation of study activities versus the activities set forth in the contract. We negotiate with the client, pursuant to the terms of the existing contract, regarding the wind up of existing study activities in order to clarify which services the client wants us to perform. Once we and the client agree on the reconciliation of study activities and the agreed upon services have been performed by us, we would record the additional revenue provided collectibility is reasonably assured.

Costs and estimated earnings in excess of related billings on uncompleted contracts represents net revenue recognized to date that is currently unbillable to the client pursuant to contractual terms. In general, amounts become billable upon the achievement of milestones or in accordance with predetermined payment schedules set forth in the contracts with our clients. Billings in excess of related costs and estimated earnings on uncompleted contracts represent amounts billed in excess of net revenue recognized at the balance sheet date.

Reimbursable Out-of-Pocket Expenses

On behalf of our clients, we pay fees to investigators and other out-of-pocket costs for which we are reimbursed at cost, without mark-up or profit. Effective January 1, 2002, in connection with the required implementation of Financial Accounting Standards Board Emerging Issues Task Force Rule No. 01-14 (EITF 01-14), Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred , out-of-pocket costs are now included in Operating Expenses, while the reimbursements received are reported separately as Reimbursement Revenue in the Consolidated Statements of Operations.

As is customary in the industry, we exclude from revenue and expense in the Consolidated Statement of Operations fees paid to investigators and the associated reimbursement since we act as agent on behalf of our clients with regard to investigators. These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of these investigator fees were $267 thousand and $1.1 million for the three and six months ended June 30, 2005, respectively. For the three and six months ended June 30, 2004, investigator fees were $1.6 million and $2.7 million, respectively.

Concentration of Credit Risk

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a small number of companies within the pharmaceutical, biotechnology and medical device industries. The significant majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of June 30, 2005, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $4.7 million. Of this amount, the exposure to our three largest clients was 79% of the total, with the three largest clients representing 45%, 20%, and 14% of total exposure, respectively. As of June 30, 2004, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $10.6 million. Of this amount, the exposure to our three largest clients was 66% of the total, with the three largest clients representing 36%, 21%, and 9% of total exposure, respectively.

Operating Expenses

Direct expenses include amounts incurred during the period that are directly related to the management or completion of a clinical trial or related project and generally include direct labor and related benefit charges,

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other direct costs and certain allocated expenses. Direct costs as a percentage of net revenues fluctuate from one period to another as a result of changes in the mix of services provided and the various studies conducted during any time period. Selling, general and administrative expenses include the salaries, wages and benefits of all administrative, finance and business development personnel, and all other support expenses not directly related to specific contracts.

Stock-Based Compensation

We have adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants. We account for grants of options to employees and directors under these plans applying the intrinsic value method provided for in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. No stock-based compensation expense is reflected in net income as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. In addition to APB Opinion No. 25, we provide the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation and by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure.

Results of Operations

Three Months Ended June 30, 2005 Compared With The Three Months Ended June 30, 2004

Net revenue for the three months ended June 30, 2005 decreased 38% to $2.3 million as compared to $3.8 million for the three months ended June 30, 2004. The decrease of $1.5 million reflects a decrease in the number of and the related contract values of clinical trial studies being managed by us in 2005. New business awards for the three months ended June 30, 2005 were approximately $9.2 million as compared to approximately $14.1 million for the three months ended June 30, 2004. For the three months ended June 30, 2005, net revenue from our largest clients amounted to 82% of our net revenue, with the largest clients representing 38%, 28%, and 16% of net revenue, respectively. For the three months ended June 30, 2004, net revenue from our largest clients amounted to 77% of our net revenue, with the largest clients representing 32%, 17%, 17%, and 11% of net revenue, respectively.

Reimbursement revenue consisted of reimbursable out-of-pocket expenses incurred on behalf of our clients. Reimbursements are made at cost, without mark-up or profit, and therefore have no impact on net income.

Direct expenses included compensation and other expenses directly related to conducting clinical studies. These costs decreased by approximately $2.3 million to $1.7 million for the three months ended June 30, 2005 from $4.0 million for the three months ended June 30, 2004. The decrease in direct expenses resulted principally from a decline in personnel costs associated with the decreased level of clinical study related activities. Direct expenses as a percentage of net revenue were 75% for the three months ended June 30, 2005 as compared to 106% for the three months ended June 30, 2004. The improvement in the gross margin was principally due to reductions in headcount and temporary independent contract personnel, which we engaged to help complete certain studies during 2004.

Selling, general, and administrative expenses included the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. Selling, general and administrative expenses for the three months ended June 30, 2005 were approximately $1.0 million, or 41% of net revenue, as compared to $1.6 million, or 41% of net revenue, for

the three months ended June 30, 2004. The decrease of $600 thousand resulted principally from a decrease in bad debt expense of $400 thousand as well as a decline in personnel costs and other cost control initiatives. Selling, general and administrative expenses, as a percentage of net revenue, remained unchanged for the period.

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Depreciation and amortization expense decreased to $132 thousand for the three months ended June 30, 2005 from $180 thousand for the three months ended June 30, 2004, primarily as a result of assets that were fully depreciated prior to the first quarter of 2005 combined with lower capital expenditures during 2004.

Loss from operations decreased by $1.4 million to $500 thousand for the quarter ended June 30, 2005, primarily for the reasons noted in the preceding paragraphs.

Net interest income for the three months ended June 30, 2005 was $19 thousand compared to net interest expense of $2 thousand for the three months ended June 30, 2004 due to an increase in the amount of cash on hand.

The effective income tax benefit rate for the three months ended June 30, 2005 and 2004 was 0% and 26%, respectively. This tax benefit related to the carryback of net operating losses incurred in 2004 to prior tax periods when we reported taxable income. Net operating losses incurred in 2005 are being carried forward and may be applied against future taxable income subject to certain limitations set forth in the Internal Revenue Code. However, due to our recent loss history, and uncertainty regarding the realization of deferred tax assets, deferred tax assets have been fully reserved as of June 30, 2005.

Net loss for the three months ended June 30, 2005 was $500 thousand, or $(0.04) per diluted share, as compared to a net loss of $1.4 million, or $(0.11) per diluted share for the three months ended June 30, 2004.

Six Months Ended June 30, 2005 Compared With The Six Months Ended June 30, 2004

Net revenue for the six months ended June 30, 2005 decreased 39% to $5.5 million as compared to $9.1 million for the six months ended June 30, 2004. The decrease of $3.6 million reflects a decrease in the number of and the related contract values of clinical trials being managed by us in 2005. New business awards and changes of scope for the six months ended June 30, 2005 were approximately $10.7 million as compared to approximately $18.9 million for the six months ended June 30, 2004. For the six months ended June 30, 2005, net revenue from our largest clients amounted to 88% of our net revenue, with the largest clients representing 32%, 19%, 17%, 10% and 10% of net revenue, respectively. For the six months ended June 30, 2004, net revenue from our largest clients amounted to 53% of our net revenue, with the largest clients representing 28%, 14%, and 11% of net revenue, respectively.

Reimbursement revenue consisted of reimbursable out-of-pocket expenses incurred on behalf of our clients. Reimbursements are made at cost, without mark-up or profit, and therefore have no impact on net income.

Direct expenses included compensation and other expenses directly related to conducting clinical studies. These costs decreased by $3.9 million to $3.8 million for the six months ended June 30, 2005 from $7.7 million for the six months ended June 30, 2004. The decrease in direct expenses resulted principally from a decline in personnel costs associated with the reduced level of clinical trial activities and cost control initiatives implemented in the third quarter of 2004. Direct expenses as a percentage of net revenue were 68% for the six months ended June 30, 2005 as compared to 85% for the six months ended June 30, 2004. The improvement in the gross margin was principally due to a decrease in direct expenses, which occurred as a result of reductions in headcount and cost control initiatives implemented in the third quarter of 2004.

Selling, general, and administrative expenses included the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. Selling, general and administrative expenses for the six months ended June 30, 2005 were $2.1 million, or 38% of net revenue, as compared to $2.9 million, or 32% of net revenue, for the six months ended June 30, 2004. The decrease of $800 thousand resulted principally from a decrease in bad debt expense of $400 thousand as well as a decline in personnel costs and ongoing cost control initiatives. The increase as a percentage of net revenue generally reflects a lower level of revenues generated for the period.

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Depreciation and amortization expense decreased to $270 thousand for the six months ended June 30, 2005 from $434 thousand for the six months ended June 30, 2004, primarily as a result of assets that were fully depreciated prior to the first quarter of 2005 combined with lower capital expenditures during 2004.

Loss from operations decreased by $1.3 million to $600 thousand for the six months ended June 30, 2005 primarily for the reasons noted in the preceding paragraphs.

Net interest income for the six months ended June 30, 2005 was $33 thousand compared to net interest expense of $4 thousand for the six months ended June 30, 2004 due to an increase in the amount of cash on hand.

The effective income tax benefit rate for the six months ended June 30, 2005 and 2004 was 0% and 26%, respectively. This tax benefit related to the carryback of net operating losses incurred in 2004 to prior tax periods when we reported taxable income. Net operating losses incurred in 2005 are being carried forward and may be applied against future taxable income subject to certain limitations set forth in the Internal Revenue Code. However, due to our recent loss history, and uncertainty regarding the realization of deferred tax assets, deferred tax assets have been fully reserved as of June 30, 2005.

Net loss for the six months ended June 30, 2005 was $600 thousand, or $(0.04) per diluted share as compared to net loss of $1.4 million, or $(0.11) per diluted share for the six months ended June 30, 2004.

Liquidity and Capital Resources

The clinical research organization industry is generally not considered capital intensive. We expect to continue to fund our operations from existing cash resources and cash flow from operations. We expect that our principal cash requirements on both a short and long-term basis will be for the funding of our operations and capital expenditures. We expect to expand our operations through internal growth, expansion of our existing services, and the development of new products and services for the pharmaceutical, biotechnology and medical device industries. We believe that our existing cash resources and cash generated from operations will provide sufficient liquidity for the foreseeable future. However, in the event that we make significant acquisitions in the future, we may need to raise additional funds through additional borrowings or the issuance of debt or equity securities.

Our contracts usually require a portion of the contract amount to be paid at the time the contract is initiated. Additional payments are generally made upon completion of negotiated performance milestones, or on a regularly scheduled basis, throughout the life of the contract. Accordingly, cash receipts do not necessarily correspond to costs incurred and revenue recognized. For terminated studies, our contracts frequently entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination.

Net revenue is recognized on a proportional performance basis. We typically receive a low volume of large-dollar receipts. As a result, the number of days net revenue outstanding in accounts receivable, costs and estimated earnings in excess of related billings, customer advances, and billings in excess of related costs will fluctuate due to the timing and size of billings and cash receipts. At June 30, 2005, the net days revenue outstanding was 44 days compared to 192 days at December 31, 2004. This decrease was primarily due to the change in billing schedules included in new contracts being signed. Historically, many legacy contracts were structured so that billings only occurred as certain milestones were met. Many of our new contracts are structured so that work is billed as it is performed. Compared to December 31, 2004,

accounts receivable decreased $1.2 million to $4.0 million at June 30, 2005, primarily due to the timing of billings and progress payments for clinical trials. Of the accounts receivable balance at June 30, 2005, less than 4% of the total was over 60 days past invoice date.

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Compared to December 31, 2004, costs and estimated earnings in excess of related billings on uncompleted contracts decreased $980 thousand to $688 thousand at June 30, 2005. The decrease primarily represents timing differences between the net revenue recognized on the trials being managed and the billing milestones or payment schedules contained in the contracts with our clients. The balance at June 30, 2005 primarily consisted of 3 clinical trials, which individually constituted 47%, 23%, and 13% of the balance. This balance is mostly attributable to a delay in the timing of billings compared to when the work was performed. The increase in the liability account billings in excess of related costs and estimated earnings on uncompleted contracts of $600 thousand to $2.4 million as of June 30, 2005 from $1.8 million as of December 31, 2004, resulted primarily from the signing of a contract in June 2005 which included a large up front payment. Customer advances increased $95 thousand to $1.2 million as of June 30, 2005 from $1.1 million as of December 31, 2004. This increase resulted primarily from an increase in the amount and value of upfront payments received from customers.

Our net cash provided by operating activities was $1.7 million for the six months ended June 30, 2005. The principal reason for this positive cash flow related to a decrease in accounts receivable of $1.2 million due to an increase in collections from customers and a $1 million decrease in costs and estimated earnings in excess of related billings offset by a decrease in accounts payable and accrued expenses of $800 thousand. For the six months ended June 30, 2004, our net cash provided by operating activities was $1.6 million. The principal reason for this positive cash flow related to a decrease in cost and estimated earnings in excess of related billings on uncompleted contracts of $3.3 million due to an increase in customer billings. Net cash used by investing activities, consisting principally of purchases of property and equipment, was $47 thousand for the six months ended June 30, 2005, compared with net cash used by investing activities of $82 thousand for the six months ended June 30, 2004. The difference related to a decrease in purchases of computer software and hardware for our corporate office and field-based personnel. Net cash used by financing activities was $1 thousand for the six months ended June 30, 2005, compared with net cash provided by financing activities of $595 thousand for the six months ended June 30, 2004. The primary difference related to cash received due to the exercise of employee stock options during 2004.

As a result of these cash flows, our cash and cash equivalents balance at June 30, 2005 was $4.8 million as compared to $3.2 million at December 31, 2004.

We previously maintained a demand line of credit with a bank under which maximum borrowings were the lesser of $2.5 million or 75% of eligible accounts receivable, as defined in the loan agreement, and interest was charged at the LIBOR Market Index Rate plus 2.65%. This line of credit expired on August 15, 2004. The Company does not currently anticipate that it will be able to replace this credit facility based on its recent operating results.

We purchased equipment of $47 thousand during the six months ended June 30, 2005. We anticipate capital expenditures of approximately $53 - $103 thousand during the remainder of 2005, primarily for leasehold improvements, software applications, personal computer equipment and related assets.

RECENTLY ISSUED ACCOUNTING STANDARDS:

In December 2004, the FASB issued SFAS No. 123 (R), Share Based Payment. Statement No. 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share based payments granted to employees. This statement is effective for the first fiscal year beginning after June 15, 2005. We will adopt Statement No. 123 (R) beginning with the first quarter of fiscal 2006. Adoption of the statement will require us to record compensation expense relating to the issuance of employee stock options. Currently, we follow APB No. 25 which does not require the recognition of compensation expense relating to

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the issuance of stock options so long as the quoted market price of our stock at the date of grant is less than or equal to the amount an employee must pay to acquire the stock. We are currently evaluating the impact the adoption of this statement will have on its consolidated financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

The fair value of cash and cash equivalents, restricted cash, accounts receivable, costs and estimated earnings in excess of related billings on uncompleted contracts, accounts payable, accrued expenses and billings in excess of related costs and estimated earnings on uncompleted contracts are not materially different than their carrying amounts as reported at June 30, 2004 and June 30, 2005.

As of June 30, 2005, the Company was not a counterparty to any forward foreign exchange contracts or any other transaction involving a derivative financial instrument.

Inflation

We believe that the effects of inflation generally do not have a material adverse impact on our operations or financial condition.

ITEM 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

Our management, including our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2005. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in this quarterly report on Form 10-Q has been appropriately recorded, processed, summarized and reported. Based on that evaluation, our principal executive and principal financial officers have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. Our management, including our principal executive and principal financial officers, has evaluated any changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2005 and has concluded that there was no change that occurred during the quarter ended June 30, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our principal executive officer and principal financial officer note that, due to human performance error, not a process deficiency, during the quarter ended June 30, 2005 we did not file a Form 10-K/A to include Part III information, which was incorporated by reference into our Form 10-K for the fiscal year ended December 31, 2004 (the Form 10-K) from a proxy statement in accordance with General Instruction G(3) to a

Form 10-K. Our definitive proxy statement including such Part III information was filed with the SEC 133 days, instead of 120 days required by General Instruction G(3), after the end of the fiscal year covered by the Form 10-K. The Form 10-K/A including the required Part III information was filed with the SEC on August 12, 2005.

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A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. The Company conducts periodic evaluations of its controls to enhance, where necessary, its procedures and controls. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The 2005 Annual Meeting of Stockholders of the Company was held on June 24, 2005. At the Annual Meeting, the stockholders voted on:

a. The election of four directors for the ensuing year. The following directors were elected to office for the ensuing year and were approved by the following votes:

	For	Withheld
Kenneth M. Borow, M.D.	9,348,818	3,008,864
Earl M. Collier, Jr.	12,306,180	51,502
Scott M. Jenkins	12,306,201	55,606
Christopher Meshginpoosh	12,302,076	51,481

ITEM 6. EXHIBITS

(a) Exhibit No.	Description
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COVALENT GROUP, INC.

Dated: August 12, 2005

By: /s/ Kenneth M. Borow, M.D.

Kenneth M. Borow, M.D.
President and Chief Executive Officer

Dated: August 12, 2005

By: /s/ Lawrence R. Hoffman

Lawrence R. Hoffman
Executive Vice President, General Counsel,

Secretary and Chief Financial Officer