ENCORIUM GROUP INC
Form 10-Q
November 14, 2006
Table of Contents

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 September 30, 2006.

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

ENCORIUM 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

COVALENT GROUP, INC.

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **x** No ¨

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. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the 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 October 2, 2006, there were 13,348,401 shares of Encorium Group, Inc. common stock outstanding, par value $.001 per share, excluding 152,932 shares in treasury.

Table of Contents

ENCORIUM GROUP, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Encorium Group, Inc.

Consolidated Balance Sheets

	September 30, 2006	December 31, 2005
Assets		
Current Assets		
Cash and cash equivalents	$ 8,693,126	$ 7,104,081
Investigator advances	568,994	1,009
Accounts receivable, less allowance of $35,093	2,694,190	1,109,781
at September 30, 2006 and December 31, 2005, respectively		
Prepaid expenses and other	354,477	312,408
Prepaid taxes	3,687	13,040
Costs and estimated earnings in excess of related billings on uncompleted contracts	817,139	383,598
Total Current Assets	13,131,613	8,923,917
Property and Equipment, Net	723,629	897,189
Deferred acquisition costs	1,311,400	
Other assets	21,665	21,665
Total Assets	$ 15,188,307	$ 9,842,771
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 1,033,386	$ 405,384
Accrued expenses	701,774	231,249
Obligations under capital leases	28,454	26,314
Billings in excess of related costs and estimated earnings on uncompleted contracts	2,787,600	1,344,794
Customer advances	3,116,995	1,020,102
Total Current Liabilities	7,668,209	3,027,843
Long Term Liabilities		
Obligations under capital leases	12,578	36,995
Other liabilities	378,109	465,369
Total Long Term Liabilities	390,687	502,364
Total Liabilities	8,058,896	3,530,207
Stockholders Equity		
Common stock, $.001 par value 25,000,000 shares authorized, 13,501,333 shares issued and outstanding respectively	13,502	13,502
Additional paid-in capital	12,330,650	12,028,415
Accumulated deficit	(4,882,642)	(5,418,116)
Accumulated other comprehensive income	126,875	147,737

Less:	7,588,385	6,771,538
Treasury stock, at cost, 152,932 shares	(458,974)	(458,974)
Total Stockholders Equity	7,129,411	6,312,564
Total Liabilities and Stockholders Equity	$ 15,188,307	$ 9,842,771

See accompanying notes to the consolidated financial statements.

2

Table of Contents

Encorium Group, Inc.

Consolidated Statements of Operations

(Unaudited)

	Three Months ended September 30, 2006	Three Months ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Net revenue	$ 3,652,152	$ 2,713,702	$ 9,245,698	$ 8,255,610
Reimbursement revenue	705,060	1,064,923	1,474,763	2,067,749
Total Revenue	4,357,212	3,778,625	10,720,461	10,323,359
Operating Expenses				
Direct	2,037,201	1,884,398	5,741,275	5,672,081
Reimbursement out-of-pocket expenses	705,060	1,064,923	1,474,763	2,067,749
Selling, general and administrative	973,902	997,677	2,934,520	3,096,970
Depreciation and amortization	79,358	122,414	262,180	392,171
Total Operating Expenses	3,795,521	4,069,412	10,412,738	11,228,971
Income (Loss) from Operations	561,691	(290,787)	307,723	(905,612)
Interest Income	82,844	48,348	232,152	86,709
Interest Expense	(1,264)	(1,924)	(4,401)	(7,006)
Net Interest Income	81,580	46,424	227,751	79,703
Income (Loss) before Income Taxes	643,271	(244,363)	535,474	(825,909)
Income Tax Benefit				
Net Income (Loss)	$ 643,271	$ (244,363)	$ 535,474	$ (825,909)
Net Income (Loss) per Common Share				
Basic	$ 0.05	$ (0.02)	$ 0.04	$ (0.06)
Diluted	$ 0.05	$ (0.02)	$ 0.04	$ (0.06)
Weighted Average Common and Common Equivalent Shares Outstanding				
Basic	13,348,401	13,348,269	13,348,401	13,346,458
Diluted	13,522,743	13,348,269	13,438,001	13,346,458

See accompanying notes to the consolidated financial statements.

Table of Contents

Encorium Group, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Operating Activities:		
Net income (loss)	$ 535,474	$ (825,909)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	262,180	392,171
Share-based compensation expense	302,235	
Changes in assets and liabilities:		
Investigator advances	(567,985)	144,925
Accounts receivable	(1,584,409)	1,987,021
Prepaid expenses and other	(42,069)	(151,487)
Prepaid taxes	9,353	1,113,867
Costs and estimated earnings in excess of related billings on uncompleted contracts	(433,541)	1,236,587
Accounts payable	628,002	(455,374)
Accrued expenses	98,025	(119,602)
Other liabilities	(87,260)	(87,256)
Billings in excess of related costs and estimated earnings on uncompleted contracts	1,442,806	698,234
Customer advances	2,096,893	(31,222)
Net Cash Provided by Operating Activities	2,659,704	3,901,955
Investing Activities:		
Deferred acquisition costs	(938,900)	
Cash paid for property and equipment	(88,620)	(46,401)
Net Cash Used In Investing Activities	(1,027,520)	(46,401)
Financing Activities:		
Repayments under capital leases	(22,277)	(17,548)
Proceeds from exercise of stock options		10,641
Net Cash Used In Financing Activities	(22,277)	(6,907)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(20,862)	(19,299)
Net Increase In Cash and Cash Equivalents	1,589,045	3,829,348
Cash and Cash Equivalents, Beginning of Period	7,104,081	3,165,986
Cash and Cash Equivalents, End of Period	$ 8,693,126	$ 6,995,334

Supplemental Disclosure of Cash Flow Information:

Amounts accrued for deferred acquisition costs were $372,500 and $0 in 2006 and 2005, respectively

See accompanying notes to the consolidated financial statements.

4

Table of Contents

Encorium Group, Inc.

Notes to Consolidated Condensed Financial Statements

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization

Encorium Group Inc (the Company), (formerly Covalent Group, Inc) is a Delaware corporation headquartered in Wayne, Pennsylvania. Effective November 1, 2006, in connection with the acquisition of Remedium Oy, the Company s European operations are based in Espoo, Finland.

The Company is clinical research organization (CRO), which specializes in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. The Company s mission is to provide its clients with high quality, full-service support for their biopharmaceutical development programs. Encorium offers therapeutic expertise, experienced team management and advanced technologies. The Company has clinical trials experience across a wide variety of therapeutic areas, such as cardiovascular, nephrology, endocrinology/metabolism, diabetes, neurology, oncology, immunology, vaccines, infectious diseases, gastroenterology, dermatology, hepatology, women s health and respiratory medicine. The Company has the capacity and expertise to conduct clinical trials on a global basis.

Basis of Presentation

The accompanying unaudited financial statements for the three and nine months ended September 30, 2006 and September 30, 2005 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 nine months ended September 30, 2006 may not necessarily be indicative of the results that may be expected for other quarters or for the year ending December 31, 2006. 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, 2005.

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 for the three and nine months ended September 30, 2006 and 2005 include our accounts and the accounts of our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Investigator Advances

We received advance payments from one of our clients as part of a long-term contract, which included a separate cash account to be utilized for payment of investigator fees. As of September 30, 2006 and December 31, 2005, this cash amount was $569 thousand and $1 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 September 30, 2006. 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. Accounts receivable included $2.7 million and $1.1 million billed to customers as of September 30, 2006 and December 31, 2005, respectively.

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 well established firms. Credit losses have historically been minimal. As of September 30, 2006, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $3.5 million. Of this amount, the exposure to our largest clients was 73% of the total, with the largest clients representing 39%, 19%, 9% and 6% of total exposure, respectively. As of December 31, 2005, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $1.5 million. Of this amount, the exposure to our three largest clients was 84% of the total, with the three largest clients representing 42%, 29%, and 13% of total exposure, respectively.

Revenue Recognition

The majority of our net revenue is recognized from fixed price contracts on a proportional performance method based on assumptions regarding the estimated completion of the project. This method is used because management considers total costs incurred to be the best available measure of progress on these contracts.

Each month costs are accumulated on each project and compared to total estimated cost to complete to determine the degree of completion for that particular project. This determines the percentage of completion for the project. This percentage of completion is multiplied by the contract value to determine the amount of revenue to be recognized. As the work progresses, original estimates may be adjusted due to revisions in the scope of work or other factors and a contract modification may be negotiated with the customer to cover additional costs. Our accounting policy for recognizing revenue for changes in scope is to recognize revenue when the Company has reached agreement with the client, the services pursuant to the change in scope have been performed, the price has been set forth in the change of scope document and collectibility is reasonably assured based on our course of dealings with the client. We bear the risk of cost overruns on work performed absent a signed contract modification. Because of the inherent uncertainties in estimating costs, it is reasonably possible that the cost estimates used will change in the near term and may have a material adverse impact on our financial performance.

Table of Contents

In the past, we have had to commit unanticipated resources to complete projects resulting in lower gross margins on those projects. These unanticipated additional costs occurred on several long term contracts which we completed or substantially completed during 2004. These contracts spanned a period of three to six years. We may experience similar situations in the future, although our current contracts in process are of a shorter duration and subject to less cost volatility. Should our estimated costs on fixed price contracts prove to be low in comparison to actual costs, future margins could be reduced, absent our ability to negotiate a contract modification.

Billings and the related payment terms from fixed price contracts are generally determined by provisions in the contract that may include certain payment schedules and the submission of required billing detail. Accordingly, cash receipts, including the receipt of up front payments and performance based milestone payments, do not necessarily correspond to costs incurred and revenue recognized on contracts. A contract s payment structure generally requires an up front payment of 10% to 15% of the contract value at or shortly after the initiation of the clinical trial, a series of periodic payments over the life of the contract and, in certain instances, milestone payments based on the achievement of certain agreed upon performance criteria. The up front payments are deferred and recognized as revenues as services are performed under the proportional performance method. Periodic payments, including performance based milestone payments, are invoiced pursuant to the terms of the contract once the agreed upon performance criteria have been achieved. Milestone payments are generally included in the total value of the contract. All payments received pursuant to the contract are recognized in accordance with the proportional performance method. In a comprehensive full service drug development program, the client would not generally purchase certain deliverables separately but as an integrated, full service arrangement in connection with the development of the drug. Examples of performance based milestones and interim deliverables include, but are not limited to, the completion of patient enrollment into the clinical trial, completion of the database and acceptance by the client of the final study report.

Clients generally may terminate a contract on short notice which might cause unplanned periods of excess capacity and reduced revenues and earnings. Client initiated delays or cancellations for ongoing cl