

ERESEARCHTECHNOLOGY INC /DE/  
Form 10-Q  
August 05, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended June 30, 2004.

or

Transitional report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transitional period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-29100

eResearchTechnology, Inc.

(Exact name of registrant as specified in its charter)

Delaware

22-3264604

(State or other jurisdiction of incorporation  
or organization)

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

30 South 17<sup>th</sup> Street  
Philadelphia, PA

19103

(Address of principal executive offices)

(Zip Code)

215-972-0420

(Registrant's telephone number, including area code)

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

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

Yes  No

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes     No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The number of shares of Common Stock, \$.01 par value, outstanding as of July 30, 2004, was 52,100,988.

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## eResearchTechnology, Inc. and Subsidiaries

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[Back to Contents](#)**Part 1. Financial Information****Item 1. Consolidated Financial Statements**

eResearchTechnology, Inc. and Subsidiaries  
 Consolidated Balance Sheets  
 (in thousands, except share and per share amounts)

|  | <b>December 31,<br/>2003</b> | <b>June 30, 2004</b> |
|--|------------------------------|----------------------|
|  |                              | (unaudited)          |
| Assets   |                              |                      |
| Current Assets:                                      |                              |                      |
| Cash and cash equivalents                            | \$ 38,364                    | \$ 55,772            |
| Short-term investments                               | 13,558                       | 21,387               |
| Accounts receivable, net                             | 13,947                       | 17,632               |
| Prepaid expenses and other                           | 2,219                        | 3,662                |
| Deferred income taxes                                | 277                          | 277                  |
|  | 68,365                       | 98,730               |
| Total current assets                                 |                              |                      |
| Property and equipment, net                          | 16,416                       | 19,617               |
| Goodwill   | 1,212                        | 1,212                |
| Investments in non-marketable securities             | 509                          | 509                  |
| Other assets   | 168                          | 302                  |
| Deferred income taxes                                | 5,308                        | 4,920                |
|  | 91,978                       | 125,290              |
| Total assets   | \$ 91,978                    | \$ 125,290           |
| Liabilities and Stockholders' Equity                 |                              |                      |
| Current Liabilities:                                 |                              |                      |
| Accounts payable                                     | \$ 3,513                     | \$ 3,797             |
| Accrued expenses                                     | 4,446                        | 4,101                |
| Income taxes payable                                 | 1,584                        | 147                  |
| Current portion of capital lease obligations         | 644                          | 452                  |
| Deferred revenues                                    | 12,401                       | 19,431               |
|  | 22,588                       | 27,928               |
| Total current liabilities                            | 22,588                       | 27,928               |
| Capital lease obligations, excluding current portion | 131                          | □                    |
| Commitments and contingencies                        |                              |                      |

Stockholders' Equity:

|   |           |            |
|---|-----------|------------|
| Preferred stock □ \$10.00 par value, 500,000 shares authorized,<br>none issued and outstanding                          | □         | □          |
| Common stock □ \$.01 par value, 175,000,000 shares authorized,<br>54,735,914 and 56,078,139 shares issued, respectively | 547       | 561        |
| Additional paid-in capital  | 54,238    | 66,856     |
| Accumulated other comprehensive income  | 1,038     | 1,109      |
| Retained earnings   | 16,826    | 32,226     |
| Treasury stock, 4,062,519 shares at cost  | (3,390)   | (3,390)    |
|   | <hr/>     | <hr/>      |
| Total stockholders' equity  | 69,259    | 97,362     |
|   | <hr/>     | <hr/>      |
| Total liabilities and stockholders' equity  | \$ 91,978 | \$ 125,290 |
|   | <hr/>     | <hr/>      |

The accompanying notes are an integral part of these statements.

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eResearchTechnology, Inc. and Subsidiaries  
Consolidated Statements of Operations  
(in thousands, except per share amounts)  
(unaudited)

|                                   | <b>Three Months Ended June<br/>30,</b> |                 | <b>Six Months Ended June 30,</b> |                  |
|-----------------------------------|--|-----------------|----------------------------------|------------------|
|                                   | <b>2003</b>                            | <b>2004</b>     | <b>2003</b>                      | <b>2004</b>      |
| Net revenues:                     |  |                 |                                  |                  |
| Licenses                          | \$ 1,154                               | \$ 2,670        | \$ 2,343                         | \$ 5,123         |
| Services                          | 13,622                                 | 25,494          | 26,016                           | 49,133           |
| <b>Total net revenues</b>         | <b>14,776</b>                          | <b>28,164</b>   | <b>28,359</b>                    | <b>54,256</b>    |
| Costs of revenues:                |  |                 |                                  |                  |
| Cost of licenses                  | 188                                    | 231             | 332                              | 353              |
| Cost of services                  | 5,630                                  | 8,663           | 10,817                           | 17,011           |
| <b>Total costs of revenues</b>    | <b>5,818</b>                           | <b>8,894</b>    | <b>11,149</b>                    | <b>17,364</b>    |
| <b>Gross margin</b>               | <b>8,958</b>                           | <b>19,270</b>   | <b>17,210</b>                    | <b>36,892</b>    |
| Operating expenses:               |  |                 |                                  |                  |
| Selling and marketing             | 1,924                                  | 2,364           | 3,747                            | 4,817            |
| General and administrative        | 1,569                                  | 2,350           | 3,078                            | 4,500            |
| Research and development          | 1,140                                  | 1,042           | 2,204                            | 2,015            |
| <b>Total operating expenses</b>   | <b>4,633</b>                           | <b>5,756</b>    | <b>9,029</b>                     | <b>11,332</b>    |
| Operating income                  | 4,325                                  | 13,514          | 8,181                            | 25,560           |
| Other income, net                 | 88                                     | 84              | 144                              | 192              |
| <b>Income before income taxes</b> | <b>4,413</b>                           | <b>13,598</b>   | <b>8,325</b>                     | <b>25,752</b>    |
| Income tax provision              | 1,644                                  | 5,466           | 3,101                            | 10,352           |
| <b>Net income</b>                 | <b>\$ 2,769</b>                        | <b>\$ 8,132</b> | <b>\$ 5,224</b>                  | <b>\$ 15,400</b> |

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|  |                   |                   |                   |                   |
|--|-------------------|-------------------|-------------------|-------------------|
| Basic net income per share                               | \$ 0.06           | \$ 0.16           | \$ 0.11           | \$ 0.30           |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted net income per share                             | \$ 0.05           | \$ 0.15           | \$ 0.10           | \$ 0.28           |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Shares used to calculate basic<br>net income per share   | 49,203            | 51,579            | 48,753            | 51,256            |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Shares used to calculate diluted<br>net income per share | 53,666            | 55,571            | 53,082            | 55,488            |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

The accompanying notes are an integral part of these statements.

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eResearchTechnology, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(in thousands)  
(unaudited)

|   | <b>Six Months Ended June 30,</b> |                  |
|---|----------------------------------|------------------|
|   | <b>2003</b>                      | <b>2004</b>      |
| Operating activities:   |                                  |                  |
| Net income  | \$ 5,224                         | \$ 15,400        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |                  |
| Depreciation and amortization   | 2,323                            | 4,143            |
| Provision for uncollectible accounts  | □                                | 84               |
| Stock option income tax benefits  | 2,005                            | 9,954            |
| Changes in operating assets and liabilities:                                      |                                  |                  |
| Accounts receivable   | (4,168)                          | (3,716)          |
| Prepaid expenses and other  | (272)                            | (1,577)          |
| Accounts payable  | 171                              | 290              |
| Accrued expenses  | (522)                            | (348)            |
| Income taxes  | 484                              | (1,089)          |
| Deferred revenues   | 532                              | 7,010            |
| Net cash provided by operating activities   | <u>5,777</u>                     | <u>30,151</u>    |
| Investing activities:   |                                  |                  |
| Purchases of property and equipment   | (2,775)                          | (7,313)          |
| Purchases of short-term investments   | (3,825)                          | (17,552)         |
| Proceeds from sales of short-term investments                                     | 3,539                            | 9,723            |
| Net cash used in investing activities   | <u>(3,061)</u>                   | <u>(15,142)</u>  |
| Financing activities:   |                                  |                  |
| Repayment of capital lease obligations  | (293)                            | (324)            |
| Proceeds from exercise of stock options   | 2,193                            | 2,681            |
| Net cash provided by financing activities   | <u>1,900</u>                     | <u>2,357</u>     |
| Effect of exchange rate changes on cash   | <u>131</u>                       | <u>42</u>        |
| Net increase in cash and cash equivalents   | 4,747                            | 17,408           |
| Cash and cash equivalents, beginning of period                                    | 17,443                           | 38,364           |
| Cash and cash equivalents, end of period  | <u>\$ 22,190</u>                 | <u>\$ 55,772</u> |



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The accompanying notes are an integral part of these statements.

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eResearchTechnology, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
(unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements, which include the accounts of eResearchTechnology, Inc. (the "Company") and its wholly owned subsidiaries, have been prepared in accordance with 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 the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the six month period ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. Further information on potential factors that could affect the Company's financial results can be found in the Company's Reports on Forms 10-K and 10-Q filed with the Securities and Exchange Commission and in this Form 10-Q.

Note 2. Summary of Significant Accounting Policies

**Principles of Consolidation.** The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

**Management's Use of Estimates.** The preparation of financial statements in accordance with accounting principles generally accepted in the United States 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Property and Equipment.** Pursuant to Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," the Company capitalizes costs associated with internally developed and/or purchased software systems for new products and enhancements to existing products that have reached the application development stage and meet recoverability tests. These costs are included in property and equipment. Capitalized costs include external direct costs of materials and services utilized in developing or obtaining internal-use software, and payroll and payroll-related expenses for employees who are directly associated with and devote time to the internal-use software project.

Amortization of capitalized software development costs is charged to cost of revenues. Amortization of capitalized software development costs was \$318,000 and \$597,000 for the three months ended June 30, 2003 and 2004, respectively, and \$570,000 and \$1,178,000 for the six months ended June 30, 2003 and 2004, respectively. For the six months ended June 30, 2003 and 2004, the Company capitalized \$433,000 and \$1,039,000, respectively, of software development costs related to labor and consulting, and \$3,000 and \$1,139,000, respectively, of software development costs related to direct costs of materials.

In accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets," when events or circumstances so indicate, the Company assesses the potential impairment of its long-lived assets based on anticipated undiscounted cash flows from the assets. Such events and circumstances include a sale of all or a significant part of the operations associated with the long-lived asset, or a significant decline in the operating performance of the asset. If an impairment is indicated, the amount of the impairment charge would be calculated by comparing the anticipated discounted future cash flows to the carrying value of the long-lived asset. At June 30, 2004, no impairment was indicated.

**Research and Development Costs.** All research and development costs have been expensed as incurred.

**Stock-Based Compensation.** In December 2002, SFAS No. 148, "Accounting for Stock-Based Compensation  Transition and Disclosure," was issued. SFAS No. 148 amended SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amended the disclosure

requirements of SFAS No. 123 related to the disclosures about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of SFAS No. 148 are applicable to interim or annual periods that end after December 15, 2002, and as such have been incorporated below.

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SFAS No. 123, as amended by SFAS No. 148, permits companies to (i) recognize as expense the fair value of stock-based awards, or (ii) continue to apply the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations, and provide pro forma net income and earnings per share disclosures for employee stock option grants as if the fair value based method defined in SFAS No. 123 had been applied. The Company continues to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosures in accordance with the provisions of SFAS Nos. 123 and 148. Under APB Opinion No. 25, the Company has not recorded any stock-based employee compensation cost associated with the Company's stock option plans, 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 grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to its stock option plans (in thousands, except per share amounts):

|  | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |           |
|--|--------------------------------|----------|------------------------------|-----------|
|  | 2003                           | 2004     | 2003                         | 2004      |
| Net income, as reported  | \$ 2,769                       | \$ 8,132 | \$ 5,224                     | \$ 15,400 |
| Deduct: Net stock-based employee compensation expense determined under fair value based method, net of related tax effects | (829)                          | (1,210)  | (1,041)                      | (1,915)   |
| Pro forma net income   | \$ 1,940                       | \$ 6,922 | \$ 4,183                     | \$ 13,485 |
| Earnings per share:  |                                |          |                              |           |
| Basic $\square$ as reported  | \$ 0.06                        | \$ 0.16  | \$ 0.11                      | \$ 0.30   |
| Basic $\square$ pro forma  | \$ 0.04                        | \$ 0.13  | \$ 0.09                      | \$ 0.26   |
| Diluted $\square$ as reported  | \$ 0.05                        | \$ 0.15  | \$ 0.10                      | \$ 0.28   |
| Diluted $\square$ pro forma  | \$ 0.04                        | \$ 0.12  | \$ 0.08                      | \$ 0.24   |

Pro forma net income reflects only options granted through June 30, 2004 and, therefore, may not be representative of the effect for future periods.

Stock Splits. On May 27, 2004, the Company effected a 3-for-2 split of its common stock. On May 29, 2003, the Company effected a 2-for-1 split of its common stock. On November 26, 2003, the Company effected a 3-for-2 split of its common stock. All share and per share data have been restated to reflect these splits of the Company's common stock as if the stock splits had occurred as of December 31, 2002.

### Note 3. Investment Impairment Charge $\square$ Non-Marketable Securities

At June 30, 2004, investments in non-marketable securities consist of an investment in Essential Group, Inc. (formerly AmericasDoctor, Inc.), which is accounted for under the cost method in accordance with APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." During 2001, in accordance with APB Opinion No. 18, management determined that a decrease in value of the investment occurred which was deemed to be other than temporary, and as a result the cost basis of the investment was written down from \$2,300,000 to \$509,000. For the three and six months ended June 30, 2003 and 2004, no additional investment impairment charge was required.

The Company will continue to assess the fair value of this investment and whether or not any decline in fair value below the current cost basis is deemed to be other than temporary. If a decline in the fair value of this investment is judged to be other than temporary, the cost basis of this investment would be written down to fair value and the amount of the write-down would be included in the Company's results.



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## Note 4. Net Income per Common Share

The Company follows SFAS No. 128, "Earnings per Share." This statement requires the presentation of basic and diluted earnings per share. Basic net income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period, adjusted for the dilutive effect of common stock equivalents, which consist of stock options, using the treasury stock method.

The tables below set forth the reconciliation of the numerators and denominators of the basic and diluted net income per share computations (in thousands, except per share amounts):

Three Months Ended June 30,

| 2003                      | Net<br>Income | Shares | Per<br>Share<br>Amount |
|---------------------------|---------------|--------|------------------------|
| Basic net income          | \$ 2,769      | 49,203 | \$ 0.06                |
| Effect of dilutive shares | □             | 4,463  | (0.01)                 |
| Diluted net income        | \$ 2,769      | 53,666 | \$ 0.05                |

## 2004

|                           |          |        |         |
|---------------------------|----------|--------|---------|
| Basic net income          | \$ 8,132 | 51,579 | \$ 0.16 |
| Effect of dilutive shares | □        | 3,992  | (0.01)  |
| Diluted net income        | \$ 8,132 | 55,571 | \$ 0.15 |

Six Months Ended June 30,

| 2003                      | Net<br>Income | Shares | Per<br>Share<br>Amount |
|---------------------------|---------------|--------|------------------------|
| Basic net income          | \$ 5,224      | 48,753 | \$ 0.11                |
| Effect of dilutive shares | □             | 4,329  | (0.01)                 |
| Diluted net income        | \$ 5,224      | 53,082 | \$ 0.10                |
| 2004                      |               |        |                        |
| Basic net income          | \$ 15,400     | 51,256 | \$ 0.30                |
| Effect of dilutive shares | □             | 4,232  | (0.02)                 |
| Diluted net income        | \$ 15,400     | 55,488 | \$ 0.28                |

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Options to purchase 7,675,041 shares of common stock were outstanding at June 30, 2003 and were included in the computation of diluted net income per share for the three and six months ended June 30, 2003.

Options to purchase 5,742,297 shares of common stock were outstanding at June 30, 2004 and were included in the computation of diluted net income per share for the three and six months ended June 30, 2004.

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## Note 5. Comprehensive Income

The Company follows SFAS No. 130, "Reporting Comprehensive Income." The Company's comprehensive income includes net income and unrealized gains and losses from foreign currency translation as follows (in thousands):

|                                    | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                    | 2003                        | 2004     | 2003                      | 2004      |
| Net income                         | \$ 2,769                    | \$ 8,132 | \$ 5,224                  | \$ 15,400 |
| Other comprehensive income (loss): |                             |          |                           |           |
| Currency translation adjustment    | 251                         | (58)     | 151                       | 71        |
| Comprehensive income               | \$ 3,020                    | \$ 8,074 | \$ 5,375                  | \$ 15,471 |

## Note 6. Recent Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." The requirements of FIN 46 for variable interest entities after January 31, 2003 were adopted on February 1, 2003. The adoption of FIN 46 did not have any impact on the Company's consolidated financial statements. In December 2003, a modification of FIN 46 was issued (FIN 46R) which delayed the effective date until no later than fiscal periods ending after March 15, 2004 and provided additional technical clarifications to implementation issues. The Company currently does not have any variable interest entities as defined in FIN 46R. The adoption of FIN 46R did not have any impact on the Company's consolidated financial statements.

## Note 7. Operating Segments / Geographic Information

Since 2003, the Company has considered its operations to consist of one segment. The development of the one segment approach corresponds to the implementation of the Company's refinement in strategic focus in late 2002, and represents management's view of the Company's operations.

The Company operates on a worldwide basis with two locations in the United States and one location in the United Kingdom, which are categorized below as North America and Europe, respectively. Revenues are allocated where the work is performed and not based upon the location of the client or the study.



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Geographic information is as follows:

**Three Months Ended June 30, 2003**

|                                      | <b>North<br/>America</b> | <b>Europe</b> | <b>Total</b> |
|--------------------------------------|--------------------------|---------------|--------------|
| License revenues                     | \$ 864                   | \$ 290        | \$ 1,154     |
| Service revenues                     | 10,233                   | 3,389         | 13,622       |
| Net revenues from external customers | \$ 11,097                | \$ 3,679      | \$ 14,776    |
| Operating income                     | \$ 2,676                 | \$ 1,649      | \$ 4,325     |
| Long-lived assets                    | \$ 12,447                | \$ 1,842      | \$ 14,289    |
| Identifiable assets                  | \$ 54,926                | \$ 8,062      | \$ 62,988    |

**Three Months Ended June 30, 2004**

|                                      | <b>North<br/>America</b> | <b>Europe</b> | <b>Total</b> |
|--------------------------------------|--------------------------|---------------|--------------|
| License revenues                     | \$ 2,527                 | \$ 143        | \$ 2,670     |
| Service revenues                     | 22,085                   | 3,409         | 25,494       |
| Net revenues from external customers | \$ 24,612                | \$ 3,552      | \$ 28,164    |
| Operating income                     | \$ 12,885                | \$ 629        | \$ 13,514    |
| Long-lived assets                    | \$ 15,873                | \$ 4,956      | \$ 20,829    |
| Identifiable assets                  | \$ 116,419               | \$ 8,871      | \$ 125,290   |

**Six Months Ended June 30, 2003**

|                                      | <b>North<br/>America</b> | <b>Europe</b> | <b>Total</b> |
|--------------------------------------|--------------------------|---------------|--------------|
| License revenues                     | \$ 1,951                 | \$ 392        | \$ 2,343     |
| Service revenues                     | 20,414                   | 5,602         | 26,016       |
| Net revenues from external customers | \$ 22,365                | \$ 5,994      | \$ 28,359    |
| Operating income                     | \$ 5,880                 | \$ 2,301      | \$ 8,181     |
| Long-lived assets                    | \$ 12,447                | \$ 1,842      | \$ 14,289    |
| Identifiable assets                  | \$ 54,926                | \$ 8,062      | \$ 62,988    |

**Six Months Ended June 30, 2004**

|  | <b>Europe</b> | <b>Total</b> |
|--|---------------|--------------|
|  |               |              |

|                                      | <b>North<br/>America</b> |                   |                   |
|--------------------------------------|--------------------------|-------------------|-------------------|
|                                      | <u>          </u>        | <u>          </u> | <u>          </u> |
| License revenues                     | \$ 4,822                 | \$ 301            | \$ 5,123          |
| Service revenues                     | 42,177                   | 6,956             | 49,133            |
|                                      | <u>          </u>        | <u>          </u> | <u>          </u> |
| Net revenues from external customers | \$ 46,999                | \$ 7,257          | \$ 54,256         |
|                                      | <u>          </u>        | <u>          </u> | <u>          </u> |
| Operating income                     | \$ 24,155                | \$ 1,405          | \$ 25,560         |
| Long-lived assets                    | \$ 15,873                | \$ 4,956          | \$ 20,829         |
| Identifiable assets                  | \$ 116,419               | \$ 8,871          | \$ 125,290        |

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Cautionary Statement for Forward-Looking Information

The following discussion and analysis should be read in conjunction with our financial statements and the related notes to the consolidated financial statements appearing elsewhere in this report. The following includes a number of forward-looking statements made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995 that reflect our current views with respect to future events and financial performance. We use words such as anticipate, believe, expect, intend, and similar expressions to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this report. These forward-looking statements are subject to risks and uncertainties such as competitive factors, technology development, market demand and our ability to obtain new contracts and accurately estimate net revenues due to variability in size, scope and duration of projects, and internal issues of the sponsoring client. These and other risk factors have been further discussed in our Report on Form 10-K for the year ended December 31, 2003. Such risks and uncertainties could cause actual results to differ materially from historical results or future predictions. Further information on potential factors that could affect our financial results can be found throughout this Form 10-Q and our other reports filed with the Securities and Exchange Commission.

### Overview

We provide technology and services that enable the pharmaceutical, biotechnology and medical device industries to collect, interpret and distribute cardiac safety and clinical data more efficiently. We are a market leader in providing centralized electrocardiographic services (Cardiac Safety services or EXPeRT® eECG services) and a leading provider of technology and services that streamline the clinical trials process by enabling our clients to evolve from traditional, paper-based methods to electronic processing using our Clinical Data Management products and services.

We were founded in 1977 to provide Cardiac Safety services to evaluate the safety of new drugs. In February 1997, we completed an initial public offering of our common stock. In October 1997, we acquired the assets and business of a provider of clinical data management technology and consulting services to the pharmaceutical, biotechnology and medical device industries. Starting in 2000, we concentrated our products and services offerings on providing premier Cardiac Safety and Clinical Data Management services.

Our solutions improve the accuracy, timeliness and efficiency of trial set-up, data collection and interpretation and new drug, biologic and device application submission. We offer Cardiac Safety services, which are utilized by clinical trial sponsors and clinical research organizations during their conduct of clinical trials. Our services include comprehensive Thorough Phase I ECG studies and the Digital ECG Franchise program, which offers a unique approach designed to address the growing capacity demands for eRT's ECG services through partnerships with sponsors that desire dedicated resources within eRT to address specific levels of cardiac safety monitoring transactions. Additionally, we offer the licensing and/or hosting of our proprietary Clinical Data Management software products and the provision of maintenance and consulting services in support of our proprietary Clinical Data Management software products. We offer the following products and services on a global basis:

*EXPeRT®*. EXPeRT® Cardiac Safety services provide intelligent, workflow enabled cardiac safety data collection, interpretation and distribution of electrocardiographic (ECG) data and images as well as analysis and physician electrocardiographer interpretation of ECGs performed on research subjects in connection with our clients' clinical trials.

*eResNet*. The eResearch Network (eResNet) technology provides an integrated end-to-end clinical research solution that includes trials, data and safety management modules.

*eDE*. eData Entry (eDE) technology provides a comprehensive electronic data capture (EDC) capability comprised of technology and consulting services formulated to deliver rapid time to benefit for electronic trial initiatives.

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*eResCom*[], eResearch Community[] (eResCom) is a central command and control portal that provides real-time information related to monitoring clinical trial activities, data quality and safety.

*Project Assurance/ Implementation Assurance.* We provide a full spectrum of consulting services for all of our products that augment the study management and implementation efforts of clients in support of their clinical research requirements.

Our license revenues consist of license fees for perpetual licenses and monthly and annual licenses. Our service revenues consist of Cardiac Safety services, technology consulting and training services and software maintenance services.

We recognize software revenues in accordance with Statement of Position 97-2, "Software Revenue Recognition," as amended by Statement of Position 98-9. Accordingly, we recognize up-front license fee revenues under the residual method when a formal agreement exists, delivery of the software and related documentation has occurred, collectability is probable and the license fee is fixed or determinable. We recognize monthly and annual license fee revenues over the term of the arrangement. Hosting service fees are recognized evenly over the term of service. Cardiac Safety services revenues consist of revenues that we provide on a fee for services basis as well as revenues from the rental of cardiac safety equipment. Such revenues are recognized as the services are performed or over the rental period. We recognize revenues from software maintenance contracts on a straight-line basis over the term of the maintenance contract, which is typically twelve months. We provide consulting and training services on a time and materials basis and recognize revenues as we perform the services.

For arrangements with multiple deliverables where the fair value of each element is known, the revenue is allocated to each component based on the relative fair values of each element. For arrangements with multiple deliverables where the fair value of the undelivered element(s) is known but the fair value of one or more of the delivered elements is not known, revenue is allocated to each component of the arrangement using the residual value method. Under the residual method, the fair value of the undelivered elements is deferred, and the remaining amount of the arrangement fee is attributed to the delivered element(s). Fair values for undelivered elements are based primarily upon stated renewal rates.

Cost of licenses consists primarily of application service provider (ASP) fees for those clients that choose hosting, the cost of producing compact disks and related documentation and royalties paid to third parties in connection with their contributions to our product development. Cost of services includes the cost of Cardiac Safety services and the cost of technology consulting, training and maintenance services. Cost of Cardiac Safety services consists primarily of direct costs related to our centralized Cardiac Safety services and includes wages, cardiac safety equipment rent and related supplies, depreciation, shipping expenses and other direct operating costs. Cost of technology consulting, training and maintenance services consists primarily of wages, fees paid to outside consultants and other direct operating costs related to our consulting and client support functions. Selling and marketing expenses consist primarily of wages and commissions paid to sales personnel, travel expenses and advertising and promotional expenditures. General and administrative expenses consist primarily of wages and direct costs for our finance, administrative, corporate information technology and executive management functions, in addition to professional service fees and corporate insurance. Research and development expenses consist primarily of wages paid to our product development staff, costs paid to outside consultants and direct costs associated with the development of our technology products.

We conduct our operations through offices in the United States and the United Kingdom (UK). Our international net revenues represented approximately 21% and 13% of total net revenues for the six months ended June 30, 2003 and 2004, respectively.

[Back to Contents](#)**Results of Operations**

The following table presents certain financial data as a percentage of total net revenues:

|                            | <b>Three Months Ended June<br/>30,</b> |             | <b>Six Months Ended June<br/>30,</b> |             |
|----------------------------|--|-------------|--------------------------------------|-------------|
|                            | <b>2003</b>                            | <b>2004</b> | <b>2003</b>                          | <b>2004</b> |
| Net revenues:              |  |             |                                      |             |
| Licenses                   | 7.8%                                   | 9.5%        | 8.3%                                 | 9.4%        |
| Services                   | 92.2%                                  | 90.5%       | 91.7%                                | 90.6%       |
| Total net revenues         | 100.0%                                 | 100.0%      | 100.0%                               | 100.0%      |
| Costs of revenues:         |  |             |                                      |             |
| Cost of licenses           | 1.3%                                   | 0.8%        | 1.2%                                 | 0.7%        |
| Cost of services           | 38.1%                                  | 30.8%       | 38.1%                                | 31.3%       |
| Total costs of revenues    | 39.4%                                  | 31.6%       | 39.3%                                | 32.0%       |
| Gross margin               | 60.6%                                  | 68.4%       | 60.7%                                | 68.0%       |
| Operating expenses:        |  |             |                                      |             |
| Selling and marketing      | 13.0%                                  | 8.4%        | 13.2%                                | 8.9%        |
| General and administrative | 10.6%                                  | 8.3%        | 10.9%                                | 8.3%        |
| Research and development   | 7.7%                                   | 3.7%        | 7.8%                                 | 3.7%        |
| Total operating expenses   | 31.3%                                  | 20.4%       | 31.9%                                | 20.9%       |
| Operating income           | 29.3%                                  | 48.0%       | 28.8%                                | 47.1%       |
| Other income, net          | 0.6%                                   | 0.3%        | 0.6%                                 | 0.4%        |
| Income before income taxes | 29.9%                                  | 48.3%       | 29.4%                                | 47.5%       |
| Income tax provision       | 11.2%                                  | 19.4%       | 11.0%                                | 19.1%       |
| Net income                 | 18.7%                                  | 28.9%       | 18.4%                                | 28.4%       |

[Back to Contents](#)**Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2003.**

The following table presents statements of operations with product line detail (in thousands):

|   | <b>Three Months Ended June<br/>30,</b> |                  |                 |                |
|---|--|------------------|-----------------|----------------|
|   | <b>2003</b>                            | <b>2004</b>      |                 |                |
| <b>Licenses:</b>                          |  |                  |                 |                |
| Net revenues                              | \$ 1,154                               | \$ 2,670         | \$ 1,516        | 131.4%         |
| Costs of revenues                         | 188                                    | 231              | 43              | 22.9%          |
| <b>Gross margin</b>                       | <b>\$ 966</b>                          | <b>\$ 2,439</b>  | <b>\$ 1,473</b> | <b>152.5%</b>  |
| <b>Services:</b>                          |  |                  |                 |                |
| <b>Cardiac Safety</b>                     |  |                  |                 |                |
| Net revenues                              | \$ 11,735                              | \$ 23,538        | \$ 11,803       | 100.6%         |
| Costs of revenues                         | 4,657                                  | 7,630            | 2,973           | 63.8%          |
| <b>Gross margin</b>                       | <b>\$ 7,078</b>                        | <b>\$ 15,908</b> | <b>\$ 8,830</b> | <b>124.8%</b>  |
| <b>Technology consulting and training</b> |  |                  |                 |                |
| Net revenues                              | \$ 911                                 | \$ 908           | \$ (3)          | (0.3%)         |
| Costs of revenues                         | 708                                    | 747              | 39              | 5.5%           |
| <b>Gross margin</b>                       | <b>\$ 203</b>                          | <b>\$ 161</b>    | <b>\$ (42)</b>  | <b>(20.7%)</b> |
| <b>Software maintenance</b>               |  |                  |                 |                |
| Net revenues                              | \$ 976                                 | \$ 1,048         | \$ 72           | 7.4%           |
| Costs of revenues                         | 265                                    | 286              | 21              | 7.9%           |
| <b>Gross margin</b>                       | <b>\$ 711</b>                          | <b>\$ 762</b>    | <b>\$ 51</b>    | <b>7.2%</b>    |
| <b>Total services</b>                     |  |                  |                 |                |
| Net revenues                              | \$ 13,622                              | \$ 25,494        | \$ 11,872       | 87.2%          |
| Costs of revenues                         | 5,630                                  | 8,663            | 3,033           | 53.9%          |
| <b>Gross margin</b>                       | <b>\$ 7,992</b>                        | <b>\$ 16,831</b> | <b>\$ 8,839</b> | <b>110.6%</b>  |
| <b>Total:</b>                             |  |                  |                 |                |
| Net revenues                              | \$ 14,776                              | \$ 28,164        | \$ 13,388       | 90.6%          |
| Costs of revenues                         | 5,818                                  | 8,894            | 3,076           | 52.9%          |
| <b>Gross margin</b>                       | <b>8,958</b>                           | <b>19,270</b>    | <b>10,312</b>   | <b>115.1%</b>  |
| <b>Operating expenses:</b>                |  |                  |                 |                |
| Selling and marketing                     | 1,924                                  | 2,364            | 440             | 22.9%          |

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|                            |          |          |          |        |
|----------------------------|----------|----------|----------|--------|
| General and administrative | 1,569    | 2,350    | 781      | 49.8%  |
| Research and development   | 1,140    | 1,042    | (98)     | (8.6%) |
|                            | <hr/>    | <hr/>    | <hr/>    |        |
| Total operating expenses   | 4,633    | 5,756    | 1,123    | 24.2%  |
|                            | <hr/>    | <hr/>    | <hr/>    |        |
| Operating income           | 4,325    | 13,514   | 9,189    | 212.5% |
| Other income, net          | 88       | 84       | (4)      | (4.5%) |
|                            | <hr/>    | <hr/>    | <hr/>    |        |
| Income before income taxes | 4,413    | 13,598   | 9,185    | 208.1% |
| Income tax provision       | 1,644    | 5,466    | 3,822    | 232.5% |
|                            | <hr/>    | <hr/>    | <hr/>    |        |
| Net income                 | \$ 2,769 | \$ 8,132 | \$ 5,363 | 193.7% |
|                            | <hr/>    | <hr/>    | <hr/>    |        |

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The following table presents costs of revenues as a percentage of related net revenues and operating expenses as a percentage of total net revenues:

|                                    | <b>Three Months Ended June<br/>30,</b> |             | <b>Increase<br/>(Decrease)</b> |
|------------------------------------|--|-------------|--------------------------------|
|                                    | <b>2003</b>                            | <b>2004</b> |                                |
| Cost of licenses                   | 16.3%                                  | 8.7%        | (7.6%)                         |
| Cost of services:                  |  |             |                                |
| Cardiac Safety                     | 39.7%                                  | 32.4%       | (7.3%)                         |
| Technology consulting and training | 77.7%                                  | 82.3%       | 4.6%                           |
| Software maintenance               | 27.2%                                  | 27.3%       | 0.1%                           |
| Total cost of services             | 41.3%                                  | 34.0%       | (7.3%)                         |
| Total costs of revenues            | 39.4%                                  | 31.6%       | (7.8%)                         |
| Operating expenses:                |  |             |                                |
| Selling and marketing              | 13.0%                                  | 8.4%        | (4.6%)                         |
| General and administrative         | 10.6%                                  | 8.3%        | (2.3%)                         |
| Research and development           | 7.7%                                   | 3.7%        | (4.0%)                         |

License revenues include the sale of four perpetual licenses in the three months ended June 30, 2004 and three in the three months ended June 30, 2003. Two of the perpetual licenses sold in 2004 generated license revenues substantially in excess of any of the perpetual licenses sold in 2003, which resulted in an increase in license revenues of \$1.2 million. Additionally, there was an increase of \$294,000 in revenues for the three months ended June 30, 2004 versus the three months ended June 30, 2003 for software licensed on a monthly and annual basis with new clients.

The increase in Cardiac Safety service revenues was primarily due to increased volume of transactions performed with both new and existing clients, and increased revenue from the rental of cardiac safety equipment, which our clients use to perform cardiac safety procedures. Additionally, the average revenue per transaction has increased with a continuation of the shift to digital ECG processing and the implementation of project assurance fees. The increase in sales volume and revenue from the rental of cardiac safety equipment in the second quarter of 2004 was partially attributed to an increase in comprehensive Thorough Phase I studies which typically include a large number of ECGs performed over a two to six month period. Thorough Phase I studies are typically large volume and of short duration. As a result, revenues resulting from Thorough Phase I studies are more difficult to predict.

The increase in software maintenance service revenues was primarily due to maintenance revenues earned in the quarter for the new perpetual licenses.

The increase in the cost of licenses was primarily due to a royalty paid to a third-party software developer related to the sale of one of the perpetual licenses. The cost of licenses as a percentage of license revenues decreased due to the increase in revenue from perpetual licenses that generally have little incremental cost of sales.

The increase in the cost of Cardiac Safety services was primarily due to an increase in labor, rental and depreciation costs and supplies associated with cardiac safety rental equipment, and increased facilities and other costs associated with expanding capabilities to meet the growth in Cardiac Safety service revenues. Additionally, amortization expense related to internal use software costs was \$597,000 for the three months ended June 30, 2004 compared with \$318,000 for the three months ended June 30, 2003. See "Liquidity and Capital Resources" for additional information related to internal use software. The decrease in the cost of Cardiac Safety services as a percentage of Cardiac Safety service revenues was primarily due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

The increase in selling and marketing expenses was primarily due to increases in commissions that resulted from the increase in commissionable revenue and higher labor costs due to new hires. These increased costs were partially offset by the savings resulting from the users conference that was held in 2003, but not in 2004. The



decrease in selling and marketing expenses as a percentage of total net revenues was primarily due to the fact that selling and marketing expenses are discretionary in nature and can be increased or decreased as deemed necessary by management and do not necessarily increase or decrease with changes in revenues.

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The increase in general and administrative expenses was due primarily to consultants assisting with internal control work required by the Sarbanes-Oxley Act, increased legal fees, higher labor costs due to new hires, non-income based taxes and depreciation. These increases were partially offset by a planned reduction in public relation expenses. The decrease in general and administrative expenses as a percentage of total net revenues was primarily due to the fact that many of the general and administrative expenses are fixed in nature.

The decrease in research and development expenses, both in absolute terms and as a percentage of total net revenues, was due primarily to a reduction in labor costs resulting from a decrease in allocated administrative costs and the capitalization of expenses related to internal use software development. Additionally, research and development expenses as a percentage of net revenues decreased due to the fact that many of the research and development expenses do not necessarily increase or decrease with changes in revenues.

Our effective tax rate was 37.3% and 40.2% for the three months ended June 30, 2003 and 2004, respectively. The 2004 tax rate increased primarily due to increased income before taxes with relatively static offsets such as tax credits for research and development. As income increased, the impact of these tax offsets has decreased as a percentage of income before income taxes, and as a result, the effective tax rate has increased.

[Back to Contents](#)**Six Months Ended June 30, 2004 Compared to Six Months Ended June 30, 2003.**

The following table presents statements of operations with product line detail (in thousands):

|   | <b>Six Months Ended June 30,</b> |                  | <b>Increase<br/>(Decrease)</b> |                |
|---|----------------------------------|------------------|--------------------------------|----------------|
|   | <b>2003</b>                      | <b>2004</b>      |                                |                |
| <b>Licenses:</b>                          |                                  |                  |                                |                |
| Net revenues                              | \$ 2,343                         | \$ 5,123         | \$ 2,780                       | 118.7%         |
| Costs of revenues                         | 332                              | 353              | 21                             | 6.3%           |
| <b>Gross margin</b>                       | <b>\$ 2,011</b>                  | <b>\$ 4,770</b>  | <b>\$ 2,759</b>                | <b>137.2%</b>  |
| <b>Services:</b>                          |                                  |                  |                                |                |
| <b>Cardiac Safety</b>                     |                                  |                  |                                |                |
| Net revenues                              | \$ 22,271                        | \$ 45,188        | \$ 22,917                      | 102.9%         |
| Costs of revenues                         | 8,980                            | 14,927           | 5,947                          | 66.2%          |
| <b>Gross margin</b>                       | <b>\$ 13,291</b>                 | <b>\$ 30,261</b> | <b>\$ 16,970</b>               | <b>127.7%</b>  |
| <b>Technology consulting and training</b> |                                  |                  |                                |                |
| Net revenues                              | \$ 1,763                         | \$ 1,753         | \$ (10)                        | (0.6%)         |
| Costs of revenues                         | 1,312                            | 1,506            | 194                            | 14.8%          |
| <b>Gross margin</b>                       | <b>\$ 451</b>                    | <b>\$ 247</b>    | <b>\$ (204)</b>                | <b>(45.2%)</b> |
| <b>Software maintenance</b>               |                                  |                  |                                |                |
| Net revenues                              | \$ 1,982                         | \$ 2,192         | \$ 210                         | 10.6%          |
| Costs of revenues                         | 525                              | 578              | 53                             | 10.1%          |
| <b>Gross margin</b>                       | <b>\$ 1,457</b>                  | <b>\$ 1,614</b>  | <b>\$ 157</b>                  | <b>10.8%</b>   |
| <b>Total services</b>                     |                                  |                  |                                |                |
| Net revenues                              | \$ 26,016                        | \$ 49,133        | \$ 23,117                      | 88.9%          |
| Costs of revenues                         | 10,817                           | 17,011           | 6,194                          | 57.3%          |
| <b>Gross margin</b>                       | <b>\$ 15,199</b>                 | <b>\$ 32,122</b> | <b>\$ 16,923</b>               | <b>111.3%</b>  |
| <b>Total</b>                              |                                  |                  |                                |                |
| Net revenues                              | \$ 28,359                        | \$ 54,256        | \$ 25,897                      | 91.3%          |
| Costs of revenues                         | 11,149                           | 17,364           | 6,215                          | 55.7%          |
| <b>Gross margin</b>                       | <b>17,210</b>                    | <b>36,892</b>    | <b>19,682</b>                  | <b>114.4%</b>  |
| <b>Operating expenses:</b>                |                                  |                  |                                |                |
| Selling and marketing                     | 3,747                            | 4,817            | 1,070                          | 28.6%          |
| General and administrative                | 3,078                            | 4,500            | 1,422                          | 46.2%          |

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|                            |                   |                   |                   |        |
|----------------------------|-------------------|-------------------|-------------------|--------|
| Research and development   | 2,204             | 2,015             | (189)             | (8.6%) |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |        |
| Total operating expenses   | 9,029             | 11,332            | 2,303             | 25.5%  |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |        |
| Operating income           | 8,181             | 25,560            | 17,379            | 212.4% |
| Other income, net          | 144               | 192               | 48                | 33.3%  |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |        |
| Income before income taxes | 8,325             | 25,752            | 17,427            | 209.3% |
| Income tax provision       | 3,101             | 10,352            | 7,251             | 233.8% |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |        |
| Net income                 | \$ 5,224          | \$ 15,400         | \$ 10,176         | 194.8% |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |        |

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The following table presents costs of revenues as a percentage of related net revenues and operating expenses as a percentage of total net revenues:

|                                    | <b>Six Months Ended June<br/>30,</b> |             | <b>Increase<br/>(Decrease)</b> |
|------------------------------------|--------------------------------------|-------------|--------------------------------|
|                                    | <b>2003</b>                          | <b>2004</b> |                                |
| Cost of licenses                   | 14.2%                                | 6.9%        | (7.3%)                         |
| Cost of services:                  |                                      |             |                                |
| Cardiac Safety                     | 40.3%                                | 33.0%       | (7.3%)                         |
| Technology consulting and training | 74.4%                                | 85.9%       | 11.5%                          |
| Software maintenance               | 26.5%                                | 26.4%       | (0.1%)                         |
| Total cost of services             | 41.6%                                | 34.6%       | (7.0%)                         |
| Total costs of revenues            | 39.3%                                | 32.0%       | (7.3%)                         |
| Operating expenses:                |                                      |             |                                |
| Selling and marketing              | 13.2%                                | 8.9%        | (4.3%)                         |
| General and administrative         | 10.9%                                | 8.3%        | (2.6%)                         |
| Research and development           | 7.8%                                 | 3.7%        | (4.1%)                         |

License revenues include an increase in revenue from the sale of perpetual licenses of \$2.1 million primarily due to the fact that two of the perpetual licenses sold in 2004 generated license revenues substantially in excess of any of the perpetual licenses sold in 2003. Additionally, there was an increase of \$661,000 in revenues for the six months ended June 30, 2004 versus the six months ended June 30, 2003 for software licensed on a monthly and annual basis with new clients.

The increase in Cardiac Safety service revenues was primarily due to increased volume of transactions performed with both new and existing clients and increased revenue from the rental of cardiac safety equipment, which our clients use to perform cardiac safety procedures. Additionally, the average revenue per transaction has increased with a continuation of the shift to digital ECG processing and the implementation of project assurance fees. The increase in sales volume and revenue from the rental of cardiac safety equipment in 2004 was partially attributed to an increase in comprehensive Thorough Phase I studies which typically include a large number of ECGs performed over a two to six month period. Thorough Phase I studies are typically large volume and of short duration. As a result, revenues resulting from Thorough Phase I studies are more difficult to predict.

The increase in software maintenance service revenues was primarily due to maintenance revenues earned in the six months ended June 2004 for the new perpetual licenses sold since June 30, 2003.

The increase in the cost of Cardiac Safety services was primarily due to an increase in labor, rental and depreciation costs and supplies associated with cardiac safety rental equipment, and increased facilities and other costs associated with expanding capabilities to meet the growth in Cardiac Safety service revenues. Additionally, amortization expense related to internal use software costs was \$1.2 million for the six months ended June 30, 2004 compared with \$570,000 for the six months ended June 30, 2003. See "Liquidity and Capital Resources" for additional information related to internal use software. The decrease in the cost of Cardiac Safety services as a percentage of Cardiac Safety service revenues was primarily due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

The increase in the cost of technology consulting and training services, both in absolute terms and as a percentage of technology consulting and training service revenues, was due primarily to increased UK payroll taxes related to the exercise of stock options as well as increased incentive compensation due to improved Companywide performance in the six months ended June 30, 2004 versus the six months ended June 30, 2003.

The increase in the cost of software maintenance services was due primarily to increased labor costs due to salary and benefit cost increases.



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The increase in selling and marketing expenses was primarily due to increases in commissions that resulted from the increase in commissionable revenue and higher labor costs due to new hires. These increased costs were partially offset by the savings resulting from the users conference that was held in 2003, but not in 2004. The decrease in selling and marketing expenses as a percentage of total net revenues was primarily due to the fact that selling and marketing expenses are discretionary in nature and can be increased or decreased as deemed necessary by management and do not necessarily increase or decrease with changes in revenues.

The increase in general and administrative expenses was due primarily to consultants assisting with internal control work required by the Sarbanes-Oxley Act, increased legal fees, higher labor costs due to new hires, an increase in incentive compensation as a result of improved performance, non-income based taxes, depreciation and insurance costs. These increases were partially offset by a planned reduction in public relation expenses. The decrease in general and administrative expenses as a percentage of total net revenues was primarily due to the fact that many of the general and administrative expenses are fixed in nature.

The decrease in research and development expenses, both in absolute terms and as a percentage of total net revenues, was due primarily to a reduction in labor costs resulting from a decrease in allocated administrative costs and the capitalization of expenses related to internal use software development. Additionally, research and development expenses as a percentage of net revenues decreased due to the fact that many of the research and development expenses do not necessarily increase or decrease with changes in revenues.

Other income, net, consisted primarily of interest income realized from our cash, cash equivalents and short-term investments, net of interest expense related to capital lease obligations. The primary reason for the increase in 2004 was higher balances of cash, cash equivalents and short-term investments in 2004 and a decrease in interest expense in 2004 related to capital leases.

Our effective tax rate was 37.3% and 40.2% for the six months ended June 30, 2003 and 2004, respectively. The 2004 tax rate increased primarily due to increased income before taxes with relatively static offsets such as tax credits for research and development. As income increased, the impact of these tax offsets has decreased as a percentage of income before income taxes, and as a result, the effective tax rate has increased.

### **Liquidity and Capital Resources**

At June 30, 2004, we had \$55.8 million of cash and cash equivalents and \$21.4 million invested in short-term investments. We generally place our investments in money market funds, municipal securities, bonds of government sponsored agencies and A1P1 rated commercial bonds and paper.

For the six months ended June 30, 2004, our operations provided cash of \$30.2 million compared to \$5.8 million for the six months ended June 30, 2003. The change was primarily the result of improved income before depreciation and amortization, income tax benefits related to the exercise of stock options and increased deferred revenues during the six months ended June 30, 2004 compared to the six months ended June 30, 2003. This change was partially offset by an increase in prepaid expenses and other.

For the six months ended June 30, 2004, our investing activities used cash of \$15.1 million compared to \$3.1 million used for the six months ended June 30, 2003. The primary cause of the change is the purchases of short-term investments, which totaled \$17.6 million for the six months ended June 30, 2004 compared to \$3.8 million for the six months ended June 30, 2003. We capitalized \$7.3 million of expenditures for property and equipment during the six months ended June 30, 2004, compared to \$2.8 million during the six months ended June 30, 2003. The increase was primarily the result of increased purchases of cardiac safety rental equipment and related computer equipment during the six months ended June 30, 2004. This equipment was used to support the increased Cardiac Safety activity and contributed significantly to the increase in revenues during the six months ended June 30, 2004.

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Included in property and equipment is internal use software associated with the development of a data and communications management services software product (EXPeRT®) used in connection with our centralized core cardiac safety electrocardiographic services. We capitalize certain internal use software costs in accordance with Statement of Position No. 98-1. The amortization is charged to the cost of Cardiac Safety services beginning at the time the software is ready for its intended use. The initial development costs of EXPeRT® were for the basic functionality required for this product. Additional development costs of EXPeRT® were incurred to develop new functionalities and enhancements. We started a new internal use software project for a machine generated Interval Duration Measurements (IDM) software product in the second quarter of 2003. We also began capitalizing costs associated with an upgrade to EXPeRT® beginning in the fourth quarter of 2003. We expect to continue capitalizing costs associated with the upgrade to EXPeRT® through approximately the first quarter of 2005. At this time, we expect to begin amortizing these costs during 2005. As this upgrade will replace many parts of the existing EXPeRT® product, we accelerated the amortization of previously capitalized labor and consulting costs to fully amortize the associated costs of the existing EXPeRT® product by the end of the first quarter of 2005, which increased monthly amortization expense by \$76,000 beginning in the fourth quarter of 2003. The start date is estimated and could be extended, which would result in a decrease in the monthly accelerated amortization.

The following table presents the internal use software costs and related amortization as of June 30, 2004 (in thousands):

|  | Amortization<br>Start Date  | Labor and<br>Consulting | Related<br>Direct<br>Costs<br>of<br>Materials | Total<br>Capitalized<br>Costs | Monthly<br>Amortization | Accumulated<br>Amortization |
|--|-----------------------------|-------------------------|---|-------------------------------|-------------------------|-----------------------------|
| EXPeRT                                 |                             |                         |   |                               |                         |                             |
| Initial costs                          | August 2002                 | \$ 2,618                | \$ 1,413                                      | \$ 4,031                      | \$ 132                  | \$ 2,366                    |
| Additional costs                       | April 2003                  | 1,003                   | 50  | 1,053                         | 50                      | 580                         |
| Machine generated IDM software product |                             |                         |   |                               |                         |                             |
| Initial costs                          | February 2004               | 449                     | 361   | 810                           | 17                      | 85                          |
| Enhancements                           | October 2004<br>(estimated) | 128                     | □   | 128                           | □                       | □                           |
| Upgrade to EXPeRT                      | April 2005 (estimated)      | 1,344                   | 1,139   | 2,483                         | □                       | □                           |
| <b>Total</b>                           |                             | <b>\$ 5,542</b>         | <b>\$ 2,963</b>                               | <b>\$ 8,505</b>               | <b>\$ 199</b>           | <b>\$ 3,031</b>             |

For the six months ended June 30, 2004, our financing activities provided cash of \$2.4 million compared to \$1.9 million for the six months ended June 30, 2003. The change was primarily the result of increased net proceeds received from the exercise of stock options during the six months ended June 30, 2004 compared to the six months ended June 30, 2003.

We have a line of credit arrangement with Wachovia Bank, National Association totaling \$3.0 million. For the three months ended June 30, 2004, we had no outstanding borrowings under the line.

We expect that existing cash and cash equivalents, short-term investments, cash flows from operations and available borrowings under our line of credit will be sufficient to meet our foreseeable cash needs for at least the next year. However, there may be acquisition and other growth opportunities that require additional external financing and we may from time to time seek to obtain additional funds from the public or private issuances of equity or debt securities. There can be no assurance that any such acquisitions will occur or that such financings will be available or available on terms acceptable to us. We announced on April 21, 2004 that our Board of Directors authorized a common stock buyback program of up to 500,000 shares. As of June 30, 2004, no shares



have been purchased under this buyback program.

**Inflation**

We believe the effects of inflation and changing prices generally do not have a material adverse effect on our results of operations or financial condition.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our primary financial market risks include fluctuations in interest rates and currency exchange rates.

#### **Interest Rate Risk**

We generally place our investments in money market funds, municipal securities, bonds of government sponsored agencies and A1P1 rated commercial bonds and paper. We actively manage our portfolio of cash equivalents and short-term investments, but in order to ensure liquidity, will only invest in instruments with high credit quality where a secondary market exists. We have not held and do not hold any derivatives related to our interest rate exposure. Due to the average maturity and conservative nature of our investment portfolio, a sudden change in interest rates would not have a material effect on the value of the portfolio. Management estimates that had the average yield of our investments, including our cash and cash equivalents, decreased by 100 basis points, our interest income for the six months ended June 30, 2004 would have decreased by less than \$325,000. This estimate assumes that the decrease occurred on the first day of 2004 and reduced the yield of each investment by 100 basis points. The impact on our future interest income of future changes in investment yields will depend largely on the gross amount of our cash, cash equivalents and short-term investments. See "Liquidity and Capital Resources" within Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### **Foreign Currency Risk**

We operate on a global basis from locations in the United States and the United Kingdom. All international net revenues are billed and expenses incurred in either U.S. dollars or pounds sterling. As such, we face exposure to adverse movements in the exchange rate of the pound sterling. As the currency rate changes, translation of the statement of operations of our UK subsidiary from the local currency to U.S. dollars affects year-to-year comparability of operating results. We do not hedge translation risks.

Management estimates that a 10% change in the exchange rate of the pound sterling would have impacted the reported operating income for the six months ended June 30, 2004 by less than \$150,000.

### **Item 4. Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended, as of June 30, 2004. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by our Company (including our consolidated subsidiaries) in our periodic filings with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. There has been no change in our internal control over financial reporting during the quarter ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## **Part II. Other Information**

### **Item 4. Submission of Matters to a Vote of Security Holders**

We held our Annual Meeting of Stockholders on April 20, 2004. The matters submitted to the stockholders for vote were the election of three directors to each serve a three-year term until 2007, approval of an amendment to our Restated Certificate of Incorporation to authorize an additional 125,000,000 shares of Common Stock, \$0.01 par value, and ratification of the appointment of KPMG LLP as our independent accountants for the year ending December 31, 2004.

At the meeting, the stockholders elected Sheldon M. Bonovitz, Gerald A. Faich, MD, MPH and Elam M. Hitchner to the Board of Directors. Sheldon M. Bonovitz was elected with 30,676,802 shares voted for the election, or 89.9% of the 34,137,930 shares outstanding and eligible to vote, with 818,398 shares withheld. Gerald A. Faich, MD, MPH was elected with 30,752,092 shares voted for the election, or 90.1% of the 34,137,930 shares outstanding and eligible to vote, with 743,108 shares withheld. Elam M. Hitchner was elected with 30,752,132 shares voted for the election, or 90.1% of the 34,137,930 shares outstanding and eligible to vote, with 743,068 shares withheld. With their election, they joined Joseph A. Esposito, David D. Gathman, Joel Morganroth, MD, Stephen S. Phillips and John M. Ryan as our Directors.

The stockholders approved the amendment to our Restated Certificate of Incorporation to authorize an additional 125,000,000 shares of Common Stock, \$0.01 par value, with 27,304,640 shares voted for the amendment, or 80.0% of the 34,137,930 shares outstanding and eligible to vote, with 4,161,249 shares voted against the amendment and 29,311 shares abstained.

In addition, the stockholders ratified the appointment of KPMG LLP as our independent accountants for 2004 with 31,075,790 shares voted for ratification, or 91.0% of the 34,137,930 shares outstanding and eligible to vote, with 406,221 shares voted against ratification and 13,189 shares abstained.

The share amounts referred to in this Item 4 have not been adjusted to reflect our 3-for-2 stock split effective on May 27, 2004.

### **Item 6. Exhibits and Reports on Form 8-K**

#### a.) Exhibits

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Statement of Chief Executive Officer Pursuant to Section 1350 of Title 18 of the United States Code

32.2 Statement of Chief Financial Officer Pursuant to Section 1350 of Title 18 of the United States Code

#### b.) Reports on Form 8-K

On April 21, 2004, we furnished a report on Form 8-K disclosing a press release we issued on April 21, 2004, reporting our results of operations for the quarter ended March 31, 2004 and providing financial guidance for the second quarter and fiscal 2004.

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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.

eResearchTechnology, Inc.  
(Registrant)

Date: August 5, 2004

By: Joseph A. Esposito

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Joseph A. Esposito  
President and Chief Executive Officer,  
Director (Principal executive officer)

Date: August 5, 2004

By: Bruce Johnson

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Bruce Johnson  
Senior Vice President and Chief Financial  
Officer (Principal financial and  
accounting officer)

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**EXHIBIT INDEX**

| <b><u>Exhibit No.</u></b> | <b><u>Exhibit</u></b>   |
|---------------------------|---|
| 31.1                      | Certification of Chief Executive Officer  |
| 31.2                      | Certification of Chief Financial Officer  |
| 32.1                      | Statement of Chief Executive Officer Pursuant to Section 1350 of Title 18 of the United States Code |
| 32.2                      | Statement of Chief Financial Officer Pursuant to Section 1350 of Title 18 of the United States Code |