ERESEARCHTECHNOLOGY INC /DE/
Form 10-Q
November 03, 2005

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 September 30, 2005.

or

Transition 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 17th 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

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

Yes No

Indicate by check mark whether the registrant is a shell company (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 October 31, 2005, was 50,005,224.

eResearchTechnology, Inc. and Subsidiaries

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Part 1. Financial Information
Item 1. Consolidated Financial Statements

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

	December 31, 2004	September 30, 2005
		(unaudited)
Assets		
Current Assets:		
Cash and cash equivalents	$ 45,806	$ 37,838
Short-term investments	22,942	33,984
Accounts receivable, net	14,798	11,632
Prepaid expenses and other	3,522	5,340
Deferred income taxes	323	323
Total current assets	87,391	89,117
Property and equipment, net	25,204	27,081
Goodwill	1,212	1,212
Other assets	782	1,100
Deferred income taxes	1,936	716
Total assets	$ 116,525	$ 119,226
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 2,455	$ 3,097
Accrued expenses	4,318	4,619
Income taxes payable	2,147	1,106
Current portion of capital lease obligations	233	142
Deferred revenues	20,325	20,730
Total current liabilities	29,478	29,694
Capital lease obligations, excluding current portion	193	88
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock — $10.00 par value, 500,000 shares authorized, none issued and outstanding	—	—
Common stock — $.01 par value, 175,000,000 shares authorized, 56,396,696 and 56,751,843 shares issued, respectively	564	568
Additional paid-in capital	69,694	72,369
Accumulated other comprehensive income	1,601	868

Retained earnings	46,550	56,615
Treasury stock, 6,067,519 and 6,747,119 shares at cost, respectively	(31,555)	(40,976)
Total stockholders’ equity	86,854	89,444
Total liabilities and stockholders equity	$ 116,525	$ 119,226

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)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
Net revenues:				
Licenses	$ 2,675	$ 1,009	$ 7,798	$ 4,418
Services	19,845	15,037	58,163	42,184
Site support	5,484	4,880	16,299	14,815
Total net revenues	28,004	20,926	82,260	61,417
Costs of revenues:				
Cost of licenses	163	82	516	319
Cost of services	6,053	6,108	18,119	18,174
Cost of site support	3,050	3,455	7,995	9,786
Total costs of revenues	9,266	9,645	26,630	28,279
Gross margin	18,738	11,281	55,630	33,138
Operating expenses:				
Selling and marketing	2,534	2,208	7,351	6,653
General and administrative	2,562	2,685	7,062	8,220
Research and development	1,031	1,081	3,046	2,975
Total operating expenses	6,127	5,974	17,459	17,848
Operating income	12,611	5,307	38,171	15,290
Other income, net	255	321	447	486
Income before income taxes	12,866	5,628	38,618	15,776
Income tax provision	5,506	1,601	15,858	5,711
Net income	$ 7,360	$ 4,027	$ 22,760	$ 10,065
Basic net income per share	$ 0.14	$ 0.08	$ 0.44	$ 0.20
Diluted net income per share	$ 0.13	$ 0.08	$ 0.41	$ 0.19
Shares used to calculate basic net income per share	51,951	50,158	51,488	50,305
Shares used to calculate diluted				

net income per share	55,473	52,979	55,483	53,145

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)

	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2005
Operating activities:		
Net income	$ 22,760	$ 10,065
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,330	7,940
Cost of sale of equipment	295	312
Provision for uncollectible accounts	126	88
Stock option income tax benefits	11,919	1,587
Investment impairment charge	—	284
Changes in operating assets and liabilities:		
Accounts receivable	(4,569)	2,934
Prepaid expenses and other	(1,988)	(2,149)
Accounts payable	(525)	691
Accrued expenses	(350)	257
Income taxes	2,393	195
Deferred revenues	10,651	522
Net cash provided by operating activities	47,042	22,726
Investing activities:		
Purchases of property and equipment	(12,033)	(10,842)
Purchases of short-term investments	(21,058)	(29,077)
Proceeds from sales of short-term investments	11,669	18,035
Net cash used in investing activities	(21,422)	(21,884)
Financing activities:		
Repayment of capital lease obligations	(608)	(196)
Proceeds from exercise of stock options	3,138	1,094
Repurchase of common stock for treasury	(6,557)	(9,421)
Net cash used in financing activities	(4,027)	(8,523)
Effect of exchange rate changes on cash	57	(287)
Net increase (decrease) in cash and cash equivalents	21,650	(7,968)
Cash and cash equivalents, beginning of period	38,364	45,806

Cash and cash equivalents, end of period	$ 60,014	$ 37,838

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 or “we”) 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 nine-month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. Further information on potential factors that could affect our financial results can be found in our Report on Form 10-K for the year ended December 31, 2004 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.

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, we capitalize 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 $484,000 and $304,000 for the three months ended September 30, 2004 and 2005, respectively, and $1,662,000 and $979,000 for the nine months ended September 30, 2004 and 2005, respectively. For the nine months ended September 30, 2004 and 2005, we capitalized $1,578,000 and $2,678,000, respectively, of software development costs related to labor and consulting, and $1,139,000 and $0, respectively, of software development costs related to direct costs of materials. As of September 30, 2005, $5,736,000 of capitalized costs have not yet been placed in service and are therefore not being amortized.

Long-lived Assets

In accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” when events or circumstances so indicate, we assess the potential impairment of our 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 September 30, 2005, no impairment was indicated.

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Software Development Costs

Research and development expenditures are charged to operations as incurred. SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed,” requires the capitalization of certain software development costs subsequent to the establishment of technological feasibility. Since software development costs have not been significant after the establishment of technological feasibility, all such costs have been charged to expense as incurred.

Stock-Based Compensation

SFAS No. 123, “Accounting for Stock-Based Compensation,” as amended by SFAS No. 148, “Accounting for Stock-Based Compensation Transition and Disclosure,” 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. We continue 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, we have not recorded any stock-based employee compensation cost associated with our 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 we had applied the fair value recognition provisions of SFAS No. 123 to our stock option plans (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
Net income, as reported	$ 7,360	$ 4,027	$ 22,760	$ 10,065
Deduct: Net stock-based employee compensation expense determined under fair value based method, net of related tax effects	(704)	(624)	(2,619)	(2,152)
Pro forma net income	$ 6,656	$ 3,403	$ 20,141	$ 7,913
Earnings per share:				
Basic as reported	$ 0.14	$ 0.08	$ 0.44	$ 0.20
Basic pro forma	$ 0.13	$ 0.07	$ 0.39	$ 0.16
Diluted as reported	$ 0.13	$ 0.08	$ 0.41	$ 0.19
Diluted pro forma	$ 0.12	$ 0.06	$ 0.36	$ 0.15

Pro forma net income reflects only options granted through September 30, 2005 and, therefore, may not be representative of the effect for future periods.

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Note 3. Net Income per Common 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. The dilutive effect of stock options is calculated 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 September 30,

2004	Net Income	Shares	Per Share Amount
Basic net income	$ 7,360	51,951	$ 0.14
Effect of dilutive shares	—	3,522	(0.01)
Diluted net income	$ 7,360	55,473	$ 0.13
2005			
Basic net income	$ 4,027	50,158	$ 0.08
Effect of dilutive shares	—	2,821	—
Diluted net income	$ 4,027	52,979	$ 0.08

Nine Months Ended September 30,

2004	Net Income	Shares	Per Share Amount
Basic net income	$ 22,760	51,488	$ 0.44
Effect of dilutive shares	—	3,995	(0.03)
Diluted net income	$ 22,760	55,483	$ 0.41
2005			
Basic net income	$ 10,065	50,305	$ 0.20
Effect of dilutive shares	—	2,840	(0.01)
Diluted net income	$ 10,065	53,145	$ 0.19

In computing diluted net income per share, 1,159,000 options to purchase shares of common stock were excluded from the computations for the three and nine months ended September 30, 2005. These options were excluded from the computations because the exercise prices of such options were greater than the average market price of our common stock during the respective periods.

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Note 4. Comprehensive Income

SFAS No. 130, “Reporting Comprehensive Income,” requires companies to classify items of other comprehensive income by their nature in the financial statements and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in-capital in the stockholders’ equity section of the balance sheet. Our comprehensive income includes net income and unrealized gains and losses from foreign currency translation as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
Net income	$ 7,360	$ 4,027	$ 22,760	$ 10,065
Other comprehensive income (loss):				
Currency translation adjustment	18	(187)	89	(733)
Comprehensive income	$ 7,378	$ 3,840	$ 22,849	$ 9,332

Note 5. Income Taxes

In the third quarter of 2005 and effective for 2004, we changed our transfer pricing methodology for the majority of our revenue categories to the profit split methodology as a result of a shift to a more global approach to the management of operations. Beginning in 2004, we shifted to a more flexible global operation where work on a study is shared among offices. While we had a transfer pricing methodology in place in 2004, we undertook a study in 2005 to determine the best available transfer pricing methodology. The profit split methodology equalizes gross margins for each legal entity based upon their respective direct costs. While we believe that the profit split methodology is the best available methodology currently, we will continue to assess the available options. In addition, we determined that all license revenue should be recognized by our operations based in the United States. As a result of the change in the transfer pricing methodology, we recorded an income tax benefit in the third quarter of 2005 of $560,000 related to the recovery of prior year taxes and an adjustment to the year-to-date effective tax rate.

Note 6. Recent Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R, “Share-Based Payment.” SFAS No. 123R is a revision of SFAS No. 123. SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. SFAS No. 123R requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees, but expresses no preference for a type of valuation model. In April 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 which provided additional guidance in implementing SFAS No. 123R without modifying the conclusions or requirements of SFAS No. 123R. In April 2005, the SEC also deferred the effective date of SFAS No. 123R for many registrants, including our company. The deferral now requires the adoption to be effective for our company no later than the first annual period beginning after June 15, 2005. We currently use the intrinsic value method to measure compensation expense for stock-based awards to our employees. Accordingly, we do not recognize any compensation expense related to stock option grants that we issue under our stock option plans. Under the new rules, we will be required to adopt a fair value based method for measuring the expense and this may materially impact our future reported results of operations. We are evaluating the impact on our results from adopting SFAS No. 123R, and we expect it to be comparable to the pro forma effects of applying the original SFAS No. 123 (see “Stock-Based Compensation” in Note 2 for further details).

In December 2004, the FASB issued SFAS No. 153, “Exchanges of Nonmonetary Assets,” which eliminates an exception in APB Opinion No. 29, “Accounting for Nonmonetary Transactions,” for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 became effective for us for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 did not have any impact on our consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 requires retroactive application of a voluntary change in accounting principle to prior period financial statements unless it is impracticable. SFAS No. 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived,

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non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 replaces APB Opinion 20, “Accounting Changes,” and SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements.” SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management currently believes that adoption of the provisions of SFAS No. 154 will not have a material impact on the Company’s consolidated financial statements.

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Note 7. Operating Segments / Geographic Information

Since 2003, we have considered our operations to consist of one segment as this represents management’s view of our operations. We operate 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. The majority of our revenues are allocated based upon the profit split methodology as discussed in Note 5. The 2004 and 2005 information presented in the tables below has been adjusted to reflect the impact of the changes in transfer pricing as if the changes were in effect as of January 1, 2004.

Geographic information is as follows (in thousands of dollars):

	Three Months Ended September 30, 2004		
	North America	**Europe**	**Total**
License revenues	$ 2,675	$ —	$ 2,675
Service revenues	16,185	3,660	19,845
Site support revenues	4,394	1,090	5,484
Net revenues from external customers	$ 23,254	$ 4,750	$ 28,004
Operating income	$ 10,948	$ 1,663	$ 12,611
Long-lived assets	$ 14,661	$ 4,956	$ 19,617
Identifiable assets	$ 121,257	$ 12,549	$ 133,806

	Three Months Ended September 30, 2005		
	North America	**Europe**	**Total**
License revenues	$ 1,009	$ —	$ 1,009
Service revenues	12,247	2,790	15,037
Site support revenues	3,670	1,210	4,880
Net revenues from external customers	$ 16,926	$ 4,000	$ 20,926
Operating income	$ 4,785	$ 522	$ 5,307
Long-lived assets	$ 17,844	$ 9,237	$ 27,081
Identifiable assets	$ 105,161	$ 14,065	$ 119,226

	Nine Months Ended September 30, 2004		
	North America	**Europe**	**Total**
License revenues	$ 7,798	$ —	$ 7,798
Service revenues	46,987	11,176	58,163

	North America	Europe	Total
Site support revenues	13,096	3,203	16,299
Net revenues from external customers	$ 67,881	$ 14,379	$ 82,260
Operating income	$ 32,902	$ 5,269	$ 38,171
Long-lived assets	$ 14,661	$ 4,956	$ 19,617
Identifiable assets	$ 121,257	$ 12,549	$ 133,806

	Nine Months Ended September 30, 2005		
	North America	**Europe**	**Total**
License revenues	$ 4,418	$ —	$ 4,418
Service revenues	33,543	8,641	42,184
Site support revenues	10,951	3,864	14,815
Net revenues from external customers	$ 48,912	$ 12,505	$ 61,417
Operating income	$ 13,645	$ 1,645	$ 15,290
Long-lived assets	$ 17,844	$ 9,237	$ 27,081
Identifiable assets	$ 105,161	$ 14,065	$ 119,226

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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 consolidated financial statements and the related notes to the consolidated financial statements appearing elsewhere in this Form 10-Q. The following discussion 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 the Company's ability to obtain new contracts and accurately estimate net revenues due to uncertain regulatory guidance, variability in size, scope and duration of projects, and internal issues at the sponsoring client, competitive factors, technological development, and market demand. These and other risk factors have been further discussed in our Form 10-K for the year ended December 31, 2004. 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 were founded in 1977 to provide Cardiac Safety services to evaluate the safety of new drugs. 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® ECG 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.

Our solutions improve the accuracy, timeliness and efficiency of trial set-up, data collection from sites worldwide, data 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 (CROs) during the conduct of clinical trials, including comprehensive Thorough QTc studies. Services may be provided through the Digital ECG Franchise program, which offers a unique approach designed to address the 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, at the client's option, 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 cardiologist interpretation of ECGs performed on research subjects in connection with our clients' clinical trials. In addition, we establish rules for standardized, semi-automated and automated workflow management, allowing audit trail accounting and generating safety and operational metrics reports for sponsors and investigators. Also included in EXPeRT® Cardiac Safety services is FDA XML delivery which provides for the delivery of ECGs, encapsulated in the now approved FDA XML schema standard, to Cardiac Safety customers.

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

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

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

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.

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Our license revenues consist of license fees for perpetual licenses and monthly and annual license sales. Our services revenues consist of Cardiac Safety services, technology consulting and training services and software maintenance services. Our site support revenue consists of cardiac safety equipment rentals and sales along with related supplies and freight.

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 fee for service revenues and are recognized as the services are performed. Site support revenues are recognized at the time of sale 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 delivered element, primarily the license fee, is not known, revenue is allocated to each component of the arrangement using the residual method provided that the fair value of all undelivered elements is known. Fair values for undelivered elements are based primarily upon stated renewal rates for future products or services.

Cost of licenses consists primarily of applications 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, depreciation 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. Cost of site support consists primarily of wages, cardiac safety equipment rent and depreciation, related supplies, cost of equipment sold, shipping expenses and other direct operating costs. 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 (US) and the United Kingdom (UK). Our international net revenues represented approximately 17% and 20% of total net revenues for the nine months ended September 30, 2004 and 2005, respectively. The majority of our revenues are allocated based upon the profit split transfer pricing methodology. The international net revenues as a percentage of total net revenues reflect the application of the change in transfer pricing methodology, as discussed in Note 5 in Notes to Consolidated Financial Statements elsewhere in this Form 10-Q, as if the changes were in effect as of January 1, 2004. See Note 7 in Notes to Consolidated Financial Statements elsewhere in this Form 10-Q for a detailed discussion of revenue recognition among the geographic segments.

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Results of Operations

Executive Overview

On October 3, 2005, we announced approximately $32 million in third quarter signings setting a new record for quarterly signings, capped by two late phase program awards from two Top 15 global pharmaceuticals awarded at quarter end. Despite the record signings, we have yet to see significant increases in signings of Thorough QTc studies in response to the May 12, 2005 ratification by the International Committee on Harmonization (ICH) of the implementation (step 4) of the cardiac safety monitoring guidance provided in E14: The Clinical Evaluation of QT/QTc Interval Prolongation and Proarrhythmic Potential for Non-Antiarrhythmic Drugs. Regulatory bodies, such as the United States Food and Drug Administration (FDA) and the ICH, provide guidance on the clinical trial process. This guidance can have a significant influence on the decisions made by our clients and potential clients regarding the use of our services. The ICH E14 guidance confirms previous guidance reinforcing the need for routine cardiac safety testing as well as Thorough QTc testing for all compounds entering the blood stream commencing early in clinical development to provide maximum guidance for later trials, as well as testing for all compounds in Phase III prior to submission for approval.

Although we believe that the ICH E14 guidance should eventually alleviate the regulatory uncertainty that has existed, we believe the uncertainty has temporarily impacted our industry, and that our results of operations have been adversely affected and could continue to be adversely affected until the guidance is fully adopted by our clients.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
Net revenues:				
Licenses	9.6%	4.8%	9.5%	7.2%
Services	70.8%	71.9%	70.7%	68.7%
Site support	19.6%	23.3%	19.8%	24.1%
Total net revenues	100.0%	100.0%	100.0%	100.0%
Costs of revenues:				
Cost of licenses	0.6%	0.4%	0.6%	0.5%
Cost of services	21.6%	29.2%	22.1%	29.6%
Cost of site support	10.9%	16.5%	9.7%	15.9%
Total costs of revenues	33.1%	46.1%	32.4%	46.0%
Gross margin	66.9%	53.9%	67.6%	54.0%
Operating expenses:				
Selling and marketing	9.1%	10.5%	8.9%	10.8%
General and administrative	9.1%	12.8%	8.6%	13.4%
Research and development	3.7%	5.2%	3.7%	4.9%
Total operating expenses	21.9%	28.5%	21.2%	29.1%
Operating income	45.0%	25.4%	46.4%	24.9%
Other income, net	0.9%	1.5%	0.5%	0.8%
Income before income taxes	45.9%	26.9%	46.9%	25.7%
Income tax provision	19.6%	7.7%	19.2%	9.3%
Net income	26.3%	19.2%	27.7%	16.4%

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Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004.

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

	Three Months Ended September 30,		Increase (Decrease)	
	2004	2005		
Licenses:				
Net revenues	$ 2,675	$ 1,009	$ (1,666)	(62.3%)
Costs of revenues	163	82	(81)	(49.7%)
Gross margin	$ 2,512	$ 927	$ (1,585)	(63.1%)
Services:				
Cardiac Safety				
Net revenues	$ 17,925	$ 13,149	$ (4,776)	(26.6%)
Costs of revenues	5,170	5,369	199	3.8%
Gross margin	$ 12,755	$ 7,780	$ (4,975)	(39.0%)
Technology consulting and training				
Net revenues	$ 811	$ 649	$ (162)	(20.0%)
Costs of revenues	599	490	(109)	(18.2%)
Gross margin	$ 212	$ 159	$ (53)	(25.0%)
Software maintenance				
Net revenues	$ 1,109	$ 1,239	$ 130	11.7%
Costs of revenues	284	249	(35)	(12.3%)
Gross margin	$ 825	$ 990	$ 165	20.0%
Total services				
Net revenues	$ 19,845	$ 15,037	$ (4,808)	(24.2%)
Costs of revenues	6,053	6,108	55	0.9%
Gross margin	$ 13,792	$ 8,929	$ (4,863)	(35.3%)
Site support:				
Net revenues	$ 5,484	$ 4,880	$ (604)	(11.0%)
Costs of revenues	3,050	3,455	405	13.3%
Gross margin	$ 2,434	$ 1,425	$ (1,009)	(41.5%)
Total:				
Net revenues	$ 28,004	$ 20,926	$ (7,078)	(25.3%)
Costs of revenues	9,266	9,645	379	4.1%

Gross margin	18,738	11,281	(7,457)	(39.8%)
Operating expenses:				
Selling and marketing	2,534	2,208	(326)	(12.9%)
General and administrative	2,562	2,685	123	4.8%
Research and development	1,031	1,081	50	4.8%
Total operating expenses	6,127	5,974	(153)	(2.5%)
Operating income	12,611	5,307	(7,304)	(57.9%)
Other income, net	255	321	66	25.9%
Income before income taxes	12,866	5,628	(7,238)	(56.3%)
Income tax provision	5,506	1,601	(3,905)	(70.9%)
Net income	$ 7,360	$ 4,027	$ (3,333)	(45.3%)

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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:

	Three Months Ended September 30,		Increase
	2004	2005	(Decrease)
Cost of licenses	6.1%	8.1%	2.0%
Cost of services:			
Cardiac Safety	28.8%	40.8%	12.0%
Technology consulting and training	73.9%	75.5%	1.6%
Software maintenance	25.6%	20.1%	(5.5%)
Total cost of services	30.5%	40.6%	10.1%
Cost of site support	55.6%	70.8%	15.2%
Total costs of revenues	33.1%	46.1%	13.0%
Operating expenses:			
Selling and marketing	9.1%	10.5%	1.4%
General and administrative	9.1%	12.8%	3.7%
Research and development	3.7%	5.2%	1.5%

License revenues decreased primarily due to a decline in the number of licenses sold and a decrease in the average license revenue for each license sold. This was largely the result of the mix of licenses sold and the number of users for each license.

The decrease in Cardiac Safety service revenues was primarily due to a decrease in volume, including a decrease in transactions performed and a decrease in average revenue per transaction. The decrease in sales volume in the third quarter of 2005 was partially attributable to a slowdown in contract signings in the prior few quarters, delays in certain studies and a decrease in comprehensive Thorough QTc studies. Thorough QTc studies are typically of large volume and of short duration, with ECGs performed over a two- to six-month period. As a result, revenues resulting from Thorough QTc studies are more difficult to predict. The decrease in average revenue per transaction was largely due to the impact of increased activity in franchise accounts and semi-automated processing, which generally include lower fees per transaction than other studies, as well as competitive pricing adjustments. If drug sponsors continue to shift towards semi-automated processing using software algorithm placed measurements in place of our manual high-resolution caliper placement system, average revenue per transaction could continue to decrease.

Technology consulting and training revenues decreased primarily due to a reduction in configuration revenue related to reporting for Cardiac Safety customers as a result of the decrease in Cardiac Safety activity.

Software maintenance revenues increased due to software licenses sold after the third quarter of 2004, which increased the number of total active licenses and their related maintenance fees.

Site support revenue decreased primarily due to a large sale of cardiac safety equipment in 2004 with only small sale transactions in 2005 as well as a decrease in revenue from the rental of cardiac safety equipment, which our clients use to perform cardiac safety procedures. This was driven largely by a reduction in the average revenue per equipment unit due to competitive pricing in the cardiac safety services market.

The decrease in cost of licenses was primarily due to a reduction in third party ASP hosting fees. The increase in cost of licenses as a percentage of license revenues was due to the decrease in perpetual license revenues which have very little incremental cost of sales, such that revenue reductions lead to minimal cost savings.

The increase in the cost of Cardiac Safety services, both in absolute terms and as a percentage of Cardiac Safety service revenues, was primarily due to labor, depreciation and increased facilities and other costs associated with expanding capabilities to meet the past and expected future growth in Cardiac Safety service revenues. These increases were partially offset by a reduction in amortization expense related to internal use software costs. See

"Liquidity and Capital Resources" for additional information related to internal use software. Additionally, the increase in the cost of Cardiac Safety services as a percentage of Cardiac Safety service revenues was due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

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The decrease in the cost of technology consulting and training services was primarily due to a reduction in labor costs. The increase in the cost of technology consulting and training services as a percentage of technology consulting and training service revenues was 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 site support, both in absolute terms and as a percentage of site support revenues, was due primarily to an increase in depreciation and rental costs associated with cardiac safety rental equipment and other costs associated with expanding capabilities to meet the past and expected growth in site support activities, including the addition of new dedicated site support facilities in both the US and UK during the second half of 2004. Partially offsetting the increase was a reduction in the cost of sales of equipment due to significantly lower equipment sales in 2005. The increase in the cost of site support as a percentage of site support revenues was also due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

The decrease in selling and marketing expenses was primarily due to lower commissions that resulted from a decrease in commissionable revenue and the conversion of certain business development directors from incentive compensation based upon commissions on individual studies to incentive compensation based upon bonus. In the third quarter of 2005, performance against bonus targets improved which resulted in an increase in bonus expense and partially offset the commission expense reduction. The increase in selling and marketing expenses as a percentage of total net revenues was due to maintaining other selling and marketing expenditures, including labor, despite the decrease in total net revenues.

The increase in general and administrative expenses, both in absolute terms and as a percentage of total net revenues, was due primarily to increased audit and internal control attestation fees of our independent registered public accountants and other professional fees and higher labor costs related to new hires. These increases were partially offset by a reduction in the cost of consultants related to internal control work required by the Sarbanes-Oxley Act. The increase in general and administrative expenses as a percentage of total net revenues was also due to the decrease in net revenues and the fact that general and administrative expenses do not necessarily increase or decrease with changes in revenues.

The increase in research and development expenses, both in absolute terms and as a percentage of total net revenues, was due primarily to increased labor and recruitment costs related to new hires and consulting costs. Research and development expenses as a percentage of net revenues also increased due to the decrease in net revenues and 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 and foreign exchange losses. Other income, net increased primarily due to a shift to higher yielding money market investments and a decrease in interest expense related to capital leases in the third quarter of 2005. The increase was partially offset by foreign exchange losses in 2005.

Our effective tax rate was 42.8% and 28.4% for the three months ended September 30, 2004 and 2005, respectively. The tax rate for the three months ended September 30, 2005 included a tax benefit of approximately $560,000 related to the recovery of prior year taxes and an adjustment to the year-to-date effective tax rate, primarily due to a change in our transfer pricing methodology. We expect our effective tax rate for the fourth quarter of 2005 to be 38.4%.

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Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004.

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

	Nine Months Ended September 30,		Increase (Decrease)	
	2004	2005		
Licenses:				
Net revenues	$ 7,798	$ 4,418	$ (3,380)	(43.3%)
Costs of revenues	516	319	(197)	(38.2%)
Gross margin	$ 7,282	$ 4,099	$ (3,183)	(43.7%)
Services:				
Cardiac Safety				
Net revenues	$ 52,298	$ 36,881	$ (15,417)	(29.5%)
Costs of revenues	15,152	15,970	818	5.4%
Gross margin	$ 37,146	$ 20,911	$ (16,235)	(43.7%)
Technology consulting and training				
Net revenues	$ 2,564	$ 1,696	$ (868)	(33.9%)
Costs of revenues	2,105	1,408	(697)	(33.1%)
Gross margin	$ 459	$ 288	$ (171)	(37.3%)
Software maintenance				
Net revenues	$ 3,301	$ 3,607	$ 306	9.3%
Costs of revenues	862	796	(66)	(7.7%)
Gross margin	$ 2,439	$ 2,811	$ 372	15.3%
Total services				
Net revenues	$ 58,163	$ 42,184	$ (15,979)	(27.5%)
Costs of revenues	18,119	18,174	55	0.3%
Gross margin	$ 40,044	$ 24,010	$ (16,034)	(40.0%)
Site support:				
Net revenues	$ 16,299	$ 14,815	$ (1,484)	(9.1%)
Costs of revenues	7,995	9,786	1,791	22.4%
Gross margin	$ 8,304	$ 5,029	$ (3,275)	(39.4%)
Total				
Net revenues	$ 82,260	$ 61,417	$ (20,843)	(25.3%)
Costs of revenues	26,630	28,279	1,649	6.2%

Gross margin	55,630	33,138	(22,492)	(40.4%)
Operating expenses:				
Selling and marketing	7,351	6,653	(698)	(9.5%)
General and administrative	7,062	8,220	1,158	16.4%
Research and development	3,046	2,975	(71)	(2.3%)
Total operating expenses	17,459	17,848	389	2.2%
Operating income	38,171	15,290	(22,881)	(59.9%)
Other income, net	447	486	39	8.7%
Income before income taxes	38,618	15,776	(22,842)	(59.1%)
Income tax provision	15,858	5,711	(10,147)	(64.0%)
Net income	$ 22,760	$ 10,065	$ (12,695)	(55.8%)

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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:

	Nine Months Ended September 30,		Increase
	2004	2005	(Decrease)
Cost of licenses	6.6%	7.2%	0.6%
Cost of services:			
Cardiac Safety	29.0%	43.3%	14.3%
Technology consulting and training	82.1%	83.0%	0.9%
Software maintenance	26.1%	22.1%	(4.0%)
Total cost of services	31.2%	43.1%	11.9%
Cost of site support	49.1%	66.1%	17.0%
Total costs of revenues	32.4%	46.0%	13.6%
Operating expenses:			
Selling and marketing	8.9%	10.8%	1.9%
General and administrative	8.6%	13.4%	4.8%
Research and development	3.7%	4.9%	1.2%

License revenues decreased primarily due to a decline in the number of licenses sold and a decrease in the average license revenue for each license sold. This was largely the result of the mix of licenses sold and the number of users for each license.

The decrease in Cardiac Safety service revenues was primarily due to a decrease in volume, including a decrease in transactions performed and a decrease in average revenue per transaction. The decrease in sales volume in the third quarter of 2005 was partially attributable to a slowdown in contract signings in the prior few quarters, delays in certain studies as well as a decrease in comprehensive Thorough QTc studies. Thorough QTc studies are typically of large volume and of short duration, with ECGs performed over a two- to six-month period. As a result, revenues resulting from Thorough QTc studies are more difficult to predict. The decrease in average revenue per transaction was largely due to the impact of increased activity in franchise accounts and semi-automated processing, which generally include lower fees per transaction than other studies, as well as competitive pricing adjustments.

Technology consulting and training revenues decreased primarily due to a reduction in consulting on Clinical Data Management software products as there was a greater number of consulting engagements in the nine months ended September 30, 2004 than in the same period in 2005.

Software maintenance revenues increased due to software licenses sold after the third quarter of 2004, which increased the number of total active licenses and their related maintenance fees.

Site support revenue decreased primarily due to a large sale of cardiac safety equipment in 2004 with only small sale transactions in 2005 as well as a decrease in revenue from the rental of cardiac safety equipment, which our clients use to perform cardiac safety procedures. This was driven largely by a reduction in the average revenue per equipment unit due to competitive pricing in the cardiac safety services market.

The decrease in cost of licenses was primarily due to a royalty paid in 2004 to a third-party software developer related to the sale of one of the perpetual licenses. The increase in cost of licenses as a percentage of license revenues was due to the decrease in perpetual license revenues which have very little incremental cost of sales, such that revenue reductions lead to minimal cost savings.

The increase in the cost of Cardiac Safety services, both in absolute terms and as a percentage of Cardiac Safety revenues, was primarily due to an increase in labor, depreciation and increased facilities and other costs associated with expanding capabilities to meet the past and expected future growth in Cardiac Safety service revenues. Partially offsetting these increases was a reduction in incentive bonuses due to higher targets set for the first half of 2005 that were not achieved, a reduction in amortization expense related to internal use software costs and a reduction in recruitment expenses. See “Liquidity and Capital Resources” for additional information related to internal use software. Additionally, the increase in the

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cost of Cardiac Safety services as a percentage of Cardiac Safety service revenues was due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

The decrease in the cost of technology consulting and training services was primarily due to a reduction in incentive bonuses due to higher targets set for the first half of 2005 that were unmet, a reduction in third-party consulting costs that was partially attributable to the decrease in related revenue, higher employee benefits costs in 2004 in connection with stock option exercises and a decrease in other labor costs. The increase in the cost of technology consulting and training services as a percentage of technology consulting and training service revenues was 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 site support, both in absolute terms and as a percentage of site support revenues, was due primarily to an increase in depreciation and rental costs associated with cardiac safety rental equipment and other costs associated with expanding capabilities to meet the past and expected growth in site support activities, including the addition of new dedicated site support facilities in both the US and UK during the second half of 2004. The increase in the cost of site support as a percentage of site support revenues was also due to the fact that some of the costs do not necessarily increase or decrease in direct relation with changes in revenue.

The decrease in selling and marketing expenses was primarily due to lower commissions that resulted from a decrease in commissionable revenue and the conversion of certain business development directors from incentive compensation based upon commission to incentive compensation based upon bonus. In the third quarter of 2005, performance against bonus targets improved which resulted in an increase in bonus expense, which partially offset the commission expense reduction. The increase in selling and marketing expenses as a percentage of total net revenues was due to maintaining other selling and marketing expenditures, including labor, despite the decrease in total net revenues.

The increase in general and administrative expenses, both in absolute terms and as a percentage of total net revenues, was due primarily to increased audit and internal control attestation fees of our independent registered public accountants and other professional fees, higher labor costs due to new hires and increases in depreciation, equipment, insurance and telephone expenses. These increases were partially offset by a reduction in incentive bonuses due to higher targets in the first half of 2005 that were not achieved. The increase in general and administrative expenses as a percentage of total net revenues was also due to the decrease in net revenues and the fact that general and administrative expenses do not necessarily increase or decrease with changes in revenues.

The decrease in research and development expenses was due primarily to a reduction in consulting costs, a reduction in incentive bonuses due to higher targets in the first half of 2005 that were not achieved and the capitalization of expenditures related to internal use software development. Partially offsetting these decreases were increased labor and recruitment costs. Research and development expenses as a percentage of net revenues increased due to the decrease in net revenues and 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, foreign exchange losses and an impairment charge related to a cost basis investment. Other income, net increased primarily due to a shift to higher yielding money market investments and a decrease in interest expense related to capital leases in the first nine months of 2005. These increases were partially offset by foreign exchange losses in 2005 as well as an impairment charge in the first quarter of 2005 related to a cost basis investment.

Our effective tax rate was 41.1% and 36.2% for the nine months ended September 30, 2004 and 2005, respectively. The tax rate for the nine months ended September 30, 2005 included a tax benefit of approximately $560,000 related to the recovery of prior year taxes and an adjustment to the year-to-date effective tax rate, primarily due to a change in our transfer pricing methodology. We expect our effective tax rate for the fourth quarter of 2005 to be 38.4%.

Liquidity and Capital Resources

At September 30, 2005, we had $37.8 million of cash and cash equivalents and $34.0 million invested in short-term investments. We generally place our investments in money market funds, municipal securities, bonds of government sponsored agencies, certificates of deposit with fixed rates with maturities of less than one year, and A1P1 rated commercial bonds and paper.

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For the nine months ended September 30, 2005, our operations provided cash of $22.7 million compared to $47.0 million during the nine months ended September 30, 2004. The change was primarily the result of lower operating income and less income tax benefits related to stock options recognized during the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004. The decrease in operating cash flow was also attributable to a much smaller increase in deferred revenues in the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004 due to franchise activity exceeding franchise payments in the 2005 period, compared to the 2004 period in which franchise payments exceeded franchise activity. This change was partially offset by a decrease in accounts receivable in the nine months ended September 30, 2005 compared to an increase in accounts receivable in the nine months ended September 30, 2004, due to lower revenue and the impact of franchise study activity, which is largely prepaid.

For the nine months ended September 30, 2005, our investing activities used cash of $21.9 million compared to $21.4 million during the nine months ended September 30, 2004. The change was primarily the result of net activity related to short-term investments, which used $11.0 million of cash for the nine months ended September 30, 2005, compared to $9.4 million for the nine months ended September 30, 2004. This increased use of cash was partially offset by a $1.2 million decrease in cash used for purchases of property and equipment.

During the nine months ended September 30, 2005, we capitalized $10.8 million of property and equipment compared to $12.0 million capitalized during the nine months ended September 30, 2004. The decrease was primarily the result of a decrease in purchases of ECG equipment, particularly equipment used in Thorough QTc studies, and software purchased in 2004 used in the development of the upgrade to EXPeRT® as discussed below.

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 ECG services. We capitalize certain internal use software costs in accordance with Statement of Position 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 to allow for semi-automated processing of ECGs in the second quarter of 2003 and further enhancements were begun in October 2004. We also began capitalizing costs associated with an upgrade to EXPeRT® (EXPeRT® 2) beginning in the fourth quarter of 2003. In April 2005, we began developing enhancements to EXPeRT® which are necessary while EXPeRT® 2 continues to be developed.

In mid-August of 2004, we revised our estimated timing for the completion of EXPeRT® 2 to continue the development work through the fourth quarter of 2005, as opposed to the first quarter of 2005 as we previously had estimated. As this upgrade will replace many parts of the existing EXPeRT® product, we previously had accelerated the amortization of 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. Beginning in mid-August of 2004, we revised the amortization period for previously capitalized labor and consulting costs to fully amortize the associated costs of the existing EXPeRT® product by the end of the fourth quarter of 2005, which decreased monthly amortization expense by $76,000 beginning in mid-August 2004. At the beginning of April 2005, we extended the life of the existing EXPeRT® product to co-exist with EXPeRT® 2 and extended the depreciation period through August 2006 which coincides with our standard useful life for internal use software of four years. This resulted in a decrease in monthly amortization expense of $32,000 beginning in April 2005.

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The following table presents the internal use software costs and related amortization as of September 30, 2005 (in thousands):

	Amortization Start Date	Labor and Consulting	Related Direct Costs of Materials	Total Capitalized Costs	Monthly Amortization	Accumulated Amortization
EXPeRT®						
Initial costs	August 2002	$ 2,618	$ 1,413	$ 4,031	$ 55	$ 3,475
Additional costs	April 2003	1,003	50	1,053	13	910
Additional enhancements	October 2005	456	□	456	□	□
Semi-automated ECG processing software						
Initial costs	February 2004	449	361	810	17	338
Enhancements	October 2004	380	□	380	8	96
Additional enhancements	April 2005	376	□	376	8	48
Upgrade to EXPeRT®	September 2006 (estimated)	4,141	1,139	5,280	□	□
Total		$ 9,423	$ 2,963	$ 12,386	$ 101	$ 4,867

For the nine months ended September 30, 2005, our financing activities used cash of $8.5 million compared to $4.0 million for the nine months ended September 30, 2004. The change was primarily the result of lower net proceeds from the exercise of stock options in the 2005 period as compared to the 2004 period as well as the repurchase of more common stock for treasury under our stock buy-back program in the 2005 period as compared to the 2004 period.

We have a line of credit arrangement with Wachovia Bank, National Association totaling $3.0 million. For the nine months ended September 30, 2005, we had no borrowings under the line.

We have a commitment to purchase approximately $5.0 million of private label cardiac safety equipment from a manufacturer over the twelve-month period ending in July 2006. This cardiac safety equipment was expected to be purchased in the normal course of business and thus does not represent a significant commitment above our expected purchases of ECG equipment during that period.

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.

In the second quarter of 2005, the stock buy-back program that was originally announced in April 2004 and extended to 2.5 million shares in October 2004, was extended by an additional 10 million shares to a total of 12.5 million shares. The purchase of a majority of the shares authorized could require us to use a significant portion of our cash, cash equivalents and short-term investments and could also require us to seek additional external financing. The stock buy-back authorization allows us, but does not require us, to purchase the authorized shares. During the third quarter of 2005, we purchased 479,600 shares of our common stock at a cost of $7.2 million.

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, certificates of deposit with fixed rates with maturities of less than one year, 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 decreased by 100 basis points, our interest income for the nine months ended September 30, 2005 would have decreased by approximately $525,000. This estimate assumes that the decrease occurred on the first day of 2005 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” as part of 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 because any cash flows from UK operations are generally reinvested in the UK.

Management estimates that a 10% change in the exchange rate of the pound sterling would have impacted the reported operating income for the nine months ended September 30, 2005 by approximately $170,000.

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 disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended, as of September 30, 2005. 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 September 30, 2005 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 2. Unregistered Sales of Equity Securities and Use of Proceeds

We announced on May 3, 2005 that our Board of Directors authorized the purchase of up to an additional 10 million shares of our common stock, which extended the stock buy-back program previously announced to authorize the repurchase of a total of 12.5 million shares. The current stock buy-back program was originally announced in April 2004 and extended to 2.5 million shares in October 2004. Through September 30, 2005, we have repurchased 2.7 million shares of the 12.5 million shares approved for repurchase. The following table provides information regarding the stock buy-back activity during the third quarter of 2005:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 2005	—	$ —	—	10,295,000
August 2005	479,600	$ 14.97	479,600	9,815,400
September 2005	—	$ —	—	9,815,400
Total	479,600	$ 14.97	479,600	

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Item 6. Exhibits

10.10	2005 Amended Bonus Plan
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.

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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: November 3, 2005 By: Joseph A. Esposito

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

Date: November 3, 2005 By: Bruce Johnson

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

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