ERESEARCHTECHNOLOGY INC /DE/
Form 10-Q
May 04, 2006

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 March 31, 2006.

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 April 28, 2006, was 49,250,643.

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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, 2005	March 31, 2006
		(unaudited)
Assets		
Current Assets:		
Cash and cash equivalents	$ 18,432	$ 7,518
Short-term investments	33,569	36,754
Accounts receivable, net	15,178	14,890
Prepaid income taxes	27	1,814
Prepaid expenses and other	2,501	3,747
Deferred income taxes	841	864
Total current assets	70,548	65,587
Property and equipment, net	28,670	30,461
Goodwill	1,212	1,212
Long-term investments	3,008	2,993
Deferred income taxes	335	558
Other assets	993	924
Total assets	$ 104,766	$ 101,735
Liabilities and Stockholders’ Equity		
Current Liabilities:		
Accounts payable	$ 2,332	$ 2,943
Accrued expenses	5,155	4,133
Income taxes payable	1,041	1,008
Current portion of capital lease obligations	153	156
Deferred revenues	16,072	13,948
Total current liabilities	24,753	22,188
Capital lease obligations, excluding current portion	40	—
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,		

56,871,010 and 57,304,927 shares issued, respectively	569	573
Additional paid-in capital	73,290	76,606
Accumulated other comprehensive income	586	719
Retained earnings	61,915	63,839
Treasury stock, 7,847,119 and 8,247,119 shares at cost, respectively	(56,387)	(62,190)
Total stockholders’ equity	79,973	79,547
Total liabilities and stockholders equity	$ 104,766	$ 101,735

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 March 31,	
	2005	**2006**
Net revenues:		
Licenses	$ 1,663	$ 638
Services	15,902	14,725
Site support	5,349	6,036
Total net revenues	22,914	21,399
Costs of revenues:		
Cost of licenses	133	76
Cost of services	6,490	6,156
Cost of site support	3,183	4,153
Total costs of revenues	9,806	10,385
Gross margin	13,108	11,014
Operating expenses:		
Selling and marketing	2,338	3,038
General and administrative	2,788	3,839
Research and development	991	1,314
Total operating expenses	6,117	8,191
Operating income	6,991	2,823
Other income (expense), net	(113)	390
Income before income taxes	6,878	3,213
Income tax provision	2,806	1,289
Net income	$ 4,072	$ 1,924
Basic net income per share	$ 0.08	$ 0.04
Diluted net income per share	$ 0.08	$ 0.04
Shares used to calculate basic net income per share	50,370	49,102
	53,324	51,685

Shares used to calculate diluted net income per share		

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)

	Three Months Ended March 31,	
	2005	2006
Operating activities:		
Net income	$ 4,072	$ 1,924
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,630	2,819
Cost of sale of equipment	269	420
Provision for uncollectible accounts	45	—
Non-cash share-based compensation	—	730
Stock option income tax benefit	540	—
Investment impairment charge	284	—
Changes in operating assets and liabilities:		
Accounts receivable	(120)	301
Prepaid expenses and other	(238)	(1,171)
Accounts payable	(275)	607
Accrued expenses	(119)	(1,030)
Income taxes	(1,370)	(2,070)
Deferred revenues	(672)	(2,135)
Net cash provided by operating activities	5,046	395
Investing activities:		
Purchases of property and equipment	(3,148)	(4,923)
Purchases of investments	(15,175)	(7,436)
Proceeds from sales of investments	6,175	4,266
Net cash used in investing activities	(12,148)	(8,093)
Financing activities:		
Repayment of capital lease obligations	(100)	(37)
Proceeds from exercise of stock options	326	1,099
Excess tax benefit related to stock options	—	1,493
Repurchase of common stock for treasury	—	(5,803)
Net cash provided by (used in) financing activities	226	(3,248)
Effect of exchange rate changes on cash	(53)	32
Net decrease in cash and cash equivalents	(6,929)	(10,914)
Cash and cash equivalents, beginning of period	45,806	18,432

Cash and cash equivalents, end of period	$ 38,877	$ 7,518

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 three-month period ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. 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, 2005 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 $0.4 million in each of the three month periods ended March 31, 2005 and 2006. For the three months ended March 31, 2005 and 2006, we capitalized $0.7 million and $1.4 million, respectively, of software development costs related to labor and consulting. As of March 31, 2006, $8.0 million 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. No impairment was indicated during either of the three month periods ended March 31, 2005 or March 31, 2006.

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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

Accounting for Stock-Based Compensation

Historically, we accounted for stock-based compensation under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees” (APB No. 25), and related interpretations. No compensation expense related to stock option plans was reflected in our Consolidated Statements of Operations as all options had an exercise price equal to the market value of the underlying common stock on the date of grant. SFAS No. 123, “Accounting For Stock-Based Compensation,” established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by SFAS No. 123, we elected to continue to apply the intrinsic-value-based method of APB No. 25, described above, and adopted only the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, “Accounting For Stock-Based Compensation Transition and Disclosure.”

On January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), “Share-Based Payment” (SFAS No. 123R), which requires that the costs resulting from all share-based payment transactions be recognized in the financial statements at their fair values. We adopted SFAS No. 123R using the modified prospective application method under which the provisions of SFAS No. 123R apply to new awards and to awards modified, repurchased, or cancelled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service had not been rendered that are outstanding as of January 1, 2006 is recognized in the Consolidated Statements of Operations over the remaining service period after such date based on the award’s original estimate of fair value. The aggregate share-based compensation expense recorded in the Consolidated Statements of Operations for the three months ended March 31, 2006 under SFAS No. 123R was $0.7 million.We would have recorded no share-based compensation expense for the three months ended March 31, 2006 if we had continued to account for share-based compensation under APB 25. For the three months ended March 31, 2006, this additional share-based compensation lowered pre-tax earnings by $0.7 million, lowered net income by $0.6 million and lowered basic and diluted earnings per share by $0.01. SFAS No. 123R also amends SFAS No. 95, Statement of Cash Flows, to require that excess tax benefits be reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows. Results for prior periods have not been restated.

Fair Value Disclosures Prior to SFAS No. 123R Adoption

Had we adopted SFAS No. 123 at the beginning of fiscal 2005, the impact on the financial results for the three months ended March 31, 2005 would have been as follows:

Net income, as reported	$	4,072
Deduct: Net stock-based employee compensation expense determined under fair-value-based method, net of related tax effects		(683)
Pro forma net income	$	3,389
Earnings per share:		
Basic as reported	$	0.08
Basic pro forma	$	0.07

Diluted as reported	$	0.08
Diluted pro forma	$	0.06

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The fair value of the Company's stock-based awards to employees during the first quarter of fiscal 2005 was estimated at the date of grant using the Black-Scholes closed form option-pricing model (Black-Scholes), assuming no dividends and using the weighted-average valuation assumptions noted in the following table. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life (estimated period of time outstanding) of the stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life, and calculated on a daily basis.

Risk-free interest rate	3.49%
Expected dividend yield	0.00%
Expected life	3.5 years
Expected volatility	63.17%

The above assumptions were used to determine the weighted average per share fair value of $7.41 for stock options granted during the first quarter of 2005.

Valuation Assumptions for Options Granted during Fiscal 2006

The fair value of each stock option granted during the first quarter of fiscal 2006 was estimated at the date of grant using Black-Scholes, assuming no dividends and using the weighted-average valuation assumptions noted in the following table. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life (estimated period of time outstanding) of the stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life, and calculated on a daily basis.

Risk-free interest rate	4.66%
Expected dividend yield	0.00%
Expected life	3.5 years
Expected volatility	