ENCORIUM GROUP INC
Form 10-Q
November 14, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2007.

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number: 0-21145

ENCORIUM GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**56-1668867**
(State or other jurisdiction of	***(I.R.S. Employer***
incorporation or organization)	***Identification No.)***
One Glenhardie Corporate Center, 1275 Drummers Lane,	**19087**

Suite 100, Wayne, Pennsylvania
(Address of principal executive offices) *(Zip Code)*

610-975-9533

(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 x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act)

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: As of November 1, 2007, there were 20,834,004 shares of Encorium Group, Inc. common stock outstanding, par value $.001 per share, excluding 230,864 shares in treasury.

Table of Contents

ENCORIUM GROUP, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENCORIUM GROUP, INC

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

	September 30, 2007	December 31, 2006
Assets		
Current Assets		
Cash and cash equivalents	$ 8,306,508	$ 5,533,093
Investigator advances	653,414	1,299,682
Accounts receivable, less allowance of $97,000 for September 30, 2007 and December 31, 2006, respectively	5,806,527	6,583,393
Prepaid expenses and other	983,699	562,940
Prepaid taxes	8,695	2,375
Costs and estimated earnings in excess of related billings on uncompleted contracts	2,039,342	1,430,045
Total Current Assets	17,798,185	15,411,528
Property and Equipment, Net	1,379,281	1,048,219
Intangible Assets		
Goodwill	15,388,299	15,372,540
Other intangibles, Net	4,703,015	6,197,584
Other assets	295,606	267,179
Total Assets	$ 39,564,386	$ 38,297,050
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 1,660,073	$ 1,371,492
Notes payable	51,352	20,768
Accrued expenses	3,021,634	3,111,614
Accrued acquisition costs	2,000,000	5,714,780
Deferred taxes	517,090	623,972
Obligations under capital leases	26,068	29,205
Billings in excess of related costs and estimated earnings on uncompleted contracts	4,435,667	3,673,435
Customer advances	3,578,790	4,774,112
Total Current Liabilities	15,290,674	19,319,378
Long Term Liabilities		
Obligations under capital leases	124,529	7,790
Deferred taxes	892,898	1,093,254
Other liabilities	540,075	574,795
Total Long Term Liabilities	1,557,502	1,675,839

Total Liabilities	16,848,176	20,995,217
Stockholders Equity		
Common stock, $.001 par value 35,000,000 shares authorized, 20,120,340 and 17,498,575 shares issued and outstanding respectively	20,120	17,499
Additional paid-in capital	30,168,492	23,720,213
Additional paid-in capital warrants	905,699	
Accumulated deficit	(7,931,791)	(5,912,527)
Accumulated other comprehensive income	251,914	174,872
Less:	23,414,434	18,000,057
Treasury stock, at cost, 230,864 shares	(698,224)	(698,224)
Total Stockholders Equity	22,716,210	17,301,833
Total Liabilities and Stockholders Equity	$ 39,564,386	$ 38,297,050

See accompanying notes to the consolidated financial statements.

Table of Contents

ENCORIUM GROUP, INC

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net revenue	$ 7,187,322	$ 3,652,152	$ 23,331,099	$ 9,245,698
Reimbursement revenue	1,068,931	705,060	3,547,889	1,474,763
Total Revenue	8,256,253	4,357,212	26,878,988	10,720,461
Operating Expenses				
Direct	4,878,728	2,037,201	14,832,536	5,741,275
Reimbursement out-of-pocket expenses	1,068,931	705,060	3,547,889	1,474,763
Selling, general and administrative	3,212,726	973,902	9,153,198	2,934,520
Depreciation and amortization	623,354	79,358	1,865,130	262,180
Total Operating Expenses	9,783,739	3,795,521	29,398,753	10,412,738
Income (Loss) from Operations	(1,527,486)	561,691	(2,519,765)	307,723
Interest Income	78,379	82,844	213,593	232,152
Interest Expense	7,280	(1,264)	(19,055)	(4,401)
Net Interest Income	85,659	81,580	194,538	227,751
Net Income (Loss) before Income Taxes	(1,441,827)	643,271	(2,325,227)	535,474
Income Tax Benefit	(160,820)		(305,963)	
Net Income (Loss)	$ (1,281,007)	$ 643,271	$ (2,019,264)	$ 535,474
Net Income (Loss) per Common Share				
Basic	$ (0.06)	$ 0.05	$ (0.11)	$ 0.04
Diluted	$ (0.06)	$ 0.05	$ (0.11)	$ 0.04
Weighted Average Common and Common Equivalent Shares Outstanding				
Basic	19,876,572	13,348,401	18,772,041	13,348,401
Diluted	19,876,572	13,522,743	18,772,041	13,438,001

See accompanying notes to the consolidated financial statements.

Table of Contents

ENCORIUM GROUP, INC

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended September 30, 2007	2006
Operating Activities:		
Net Income (Loss)	$ (2,019,264)	$ 535,474
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	1,865,130	262,180
Share-based compensation expense	240,365	302,235
Changes in assets and liabilities;		
Investigator advances	647,504	(567,985)
Accounts receivable	1,111,721	(1,584,409)
Prepaid expenses and other	(379,355)	(42,069)
Prepaid taxes	(6,320)	9,353
Costs and estimated earnings in excess of related billings on uncompleted contracts	(579,562)	(433,541)
Other Assets	(8,054)	
Accounts payable	216,085	628,002
Accrued expenses	(293,465)	98,025
Other liabilities	(54,984)	(87,260)
Deferred taxes	(314,271)	
Billings in excess of related costs and estimated earnings on uncompleted contracts	646,351	1,442,806
Customer advances	(1,323,915)	2,096,893
Net Cash (Used) Provided By Operating Activities	(252,034)	2,659,704
Investing Activities:		
Remedium acquisition	(1,730,539)	(938,900)
Purchases of property and equipment	(564,427)	(88,620)
Net Cash Used By Investing Activities	(2,294,966)	(1,027,520)
Financing Activities:		
Net payments under capital leases	(4,908)	(22,277)
Proceeds from stock issue and warrants	4,661,918	
Proceeds from exercise of stock options	454,315	
Net proceeds from short-term borrowings	27,118	
Net Cash Provided (Used) By Financing Activities	5,138,443	(22,277)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	181,972	(20,862)
Net Increase In Cash and Cash Equivalents	2,773,415	1,589,045
Cash and Cash Equivalents, Beginning of Period	5,533,093	7,104,081
Cash and Cash Equivalents, End of Period	$ 8,306,508	$ 8,693,126

See accompanying notes to the consolidated financial statements.

4

Table of Contents

ENCORIUM GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization

Encorium Group, Inc. (the Company) (formally Covalent Group, Inc) is a Delaware corporation headquartered in Wayne, Pennsylvania with European operations based in Espoo, Finland.

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

Basis of Presentation

The accompanying unaudited financial statements for the three and nine months ended September 30, 2007 have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (primarily consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2007 may not necessarily be indicative of the results that may be expected for other quarters or for the year ending December 31, 2007. For further information, refer to the financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Use of Estimates

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

Table of Contents

Consolidation

The consolidated financial statements for the three and nine months ended September 30, 2007 and 2006 include our accounts and the accounts of our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Investigator Advances

We received advance payments from several of our clients as part of certain long-term contracts, which included a separate cash account to be utilized for payment of investigator fees. As of September 30, 2007 and December 31, 2006, this cash amount was $653 thousand and $1.3 million, respectively. This amount is also included in customer advances in the accompanying balance sheets.

Accounts Receivable

Accounts receivable, net of an allowance for doubtful accounts, consists of customer billings pursuant to contractual terms related to work performed as of September 30, 2007. In general, amounts become billable upon the achievement of milestones or in accordance with predetermined payment schedules set forth in the contracts with our clients.

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a number of companies within the pharmaceutical, biotechnology and medical device industries. The majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of September 30, 2007, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $7.8 million. Of this amount, the exposure to our three largest clients was 47% of the total, with the three largest clients representing 17%, 17% and 13% of total exposure, respectively. As of December 31, 2006, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $8 million. Of this amount, the exposure to our three largest clients was 52% of the total, with the three largest clients representing 35%, 9%, and 8% of total exposure, respectively.

Revenue Recognition

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

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

Table of Contents

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

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

Clients generally may terminate a contract on short notice which might cause unplanned periods of excess capacity and reduced revenues and earnings. Client initiated delays or cancellations for ongoing clinical trials can come suddenly and may not be foreseeable. To offset the effects of early termination of significant contracts, we attempt to negotiate the payment of an early termination fee as part of the original contract. Generally, we have not been successful in negotiating such fees. Our contracts typically require payment to us of expenses incurred to wind down a study and fees earned to date. Therefore, revenue recognized prior to cancellation does not require a significant adjustment upon cancellation. If we determine that a loss will result from the performance of a fixed price contract, the entire amount of the estimated loss is charged against income in the period in which such determination is made.

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

Our operations have experienced, and may continue to experience, period-to-period fluctuations in net service revenue and results from operations. Because we generate a large proportion of our revenues from services performed at hourly rates, our revenues in any period is directly related to the number of employees and the number of hours worked by those employees during that period. Our results of operations in any one quarter can fluctuate depending upon, among other things, the number of weeks in the quarter, the number and related contract value of ongoing client engagements, the commencement, postponement and termination of engagements in the quarter, the mix of revenue, the extent of cost overruns, employee hiring, employee utilization, vacation patterns, exchange rate fluctuations and other factors.

Reimbursable Out-of-Pocket Expenses

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

As is customary in the industry, we will continue to exclude from revenue and expense in the Consolidated Statements of Operations fees paid to investigators and the associated reimbursement since we acts as an agent on behalf of the pharmaceutical company sponsors with regard to investigator payments, in accordance with the Financial Accounting Standards Board Emerging Issues Task Force Rule No. 99-19 (EITF 99-19), *Reporting Revenue Gross as a Principal versus Net as an Agent* . These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of these investigator fees were $429 thousand and $3.1 million for the three and nine months ended September 30, 2007. For the three and nine months ended September 30, 2006, investigator fees were $1.3 million and $1.5 million, respectively.

Share-Based Compensation

We have adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants.

Effective January 1, 2006, we adopted Statements of Financial Accounting Standards (SFAS) No. 123R using the Modified Prospective Approach. SFAS 123R revises SFAS No. 123, *Accounting for Stock Based Compensation* (SFAS No. 123) and supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25). SFAS No. 123R requires the costs for all share-based payments to employees, including grants of employee stock options, to be recognized in financial statements based on their fair values at grant date, or the date of later modification, over the requisite period. In addition, SFAS No. 123R requires unrecognized cost (based on the amounts previously disclosed in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized in the financial statements over the remaining requisite period. Accordingly, prior period amounts have not been restated. See Note 7 for further detail regarding the adoption of this standard.

Goodwill and Intangible Assets

The Company follows the provisions of SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, applicable to business combinations. In accordance with these standards, goodwill acquired in connection with the acquisition of Remedium was not amortized. However, the identifiable intangible assets acquired in connection with the acquisition of Remedium will be amortized over their useful lives. Under SFAS No. 142, goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If carrying value exceeds current fair value, then goodwill is considered impaired and is reduced to fair value via a charge to earnings. The identifiable intangibles acquired in connection with the acquisition of Remedium are also subject to impairment testing under SFAS No. 142, whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. Should the value of goodwill or one or more of the identifiable intangibles become impaired, our consolidated earnings and net worth may be materially and adversely affected. In addition, impairment testing involves the use of accounting estimates and assumptions, changes in which could materially impact our financial condition or operating performance if actual results differ from such estimates and assumptions. The Company performs an annual test for impairment of goodwill during the fourth quarter of each year. As of September 30, 2007, we had goodwill of approximately $15.4 million and intangibles, net of amortization, of approximately $4.7 resulting from the acquisition of Remedium on November 1, 2006.

Reclassifications

The Company reclassified $11,725 of realized foreign exchange losses that were incurred for the first six months ended June 30, 2007 from interest expense to SG&A on its Consolidated Condensed Statements of Operations for the three months ended September 30, 2007.

2. RECENTLY ISSUED ACCOUNTING STANDARDS:

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement is effective in the first fiscal year that begins after November 15, 2007. We are currently evaluating the impact that the adoption of SFAS No. 159 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the future impact of SFAS No. 157 on our consolidated financial statements.

In July 2006, the FASB issued Financial Interpretation Number (FIN) 48, *Accounting for Uncertainty in Income Taxes,* which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109, Accounting for Income Taxes . The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 had no material impact on our consolidated financial statements.

3. EARNINGS PER SHARE

Earnings per share is calculated in accordance with SFAS No. 128, *Earnings Per Share* . Basic earnings per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares plus the dilutive effect of outstanding stock options under our equity incentive plans. Stock options outstanding not included in the table below because of their anti-dilutive effect for the three and nine months ended September 30, 2007 were 140,716 and 299,745, respectively. Stock options outstanding not included in the table below because of their ant-dilutive effect for the nine months ended September 30, 2006 were 304,500 and 370,800, respectively.

Table of Contents

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

Net Income (Loss) Per common share & common Equivalent Share

	Three months ended September 30, 2007	2006	Nine months ended September 30, 2007	2006
Net Income (Loss)	$ (1,281,007)	$ 643,271	$ (2,019,264)	$ 535,474
Weighted average number of common shares outstanding used in computing basic earnings per share	19,876,572	13,348,401	18,772,041	13,348,401
Dilutive effect of stock options outstanding		174,342		89,600
Weighted average shares used in computing diluted earnings per share	19,876,572	13,522,743	18,772,041	13,438,001
Basic earnings (loss) per share	$ (0.06)	$ 0.05	$ (0.11)	$ 0.04
Diluted earnings (loss) per share	$ (0.06)	$ 0.05	$ (0.11)	$ 0.04

4. COMPREHENSIVE INCOME

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

	Three Months ended September 30, 2007	2006	Nine Months ended September 30, 2007	2006
Net income (loss)	$ (1,281,007)	$ 643,271	$ (2,019,264)	$ 535,474
Foreign currency translation adjustment	4,843	(9,404)	77,042	(20,862)
Comprehensive income (loss)	$ (1,276,164)	$ 633,867	$ (1,942,222)	$ 514,612

5. SEGMENT INFORMATION

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

Table of Contents

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

	Three Months Ended September 30, 2007		Three Months Ended September 30, 2006		Nine Months Ended September 30, 2007		Nine Months Ended September 30, 2006	
	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts
Client A	16%	2	35%	8	15%	2	23%	8
Client B	10%	5	22%	1	12%	5	22%	2
Client C	6%	3	11%	1	13%	9	12%	1
Client D	0%		7%	3	0%		11%	3
Top Clients	32%	10	75%	13	40%	16	68%	14

Client A, B, C and D and in the table above represent the largest clients for each period, but do not represent the same client for each year shown. We have no other customers that comprise 10% of our net revenues.

The following table summarizes the distribution of net revenues from external clients by geographical region for the three and nine months ended September 30, 2007 and September 30, 2006.

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
U.S.	$ 2,358,031	$ 3,572,903	$ 9,385,339	$ 8,948,430
Finland	3,841,653		10,842,167	
Rest of Europe	987,638	79,249	3,103,593	297,268
Total	$ 7,187,322	$ 3,652,152	$ 23,331,099	$ 9,245,698

The following table summarizes the distribution of the Company s long lived assets by geographical region as of September 30, 2007 and 2006.

	As of September 30, 2007	As of September 30, 2006
U.S.	$ 1,083,137	$ 720,535
Europe	20,387,458	3,094
Total	$ 21,470,595	$ 723,629

The Company s long lived assets primarily consist of property and equipment, goodwill and other intangible assets.

6. <u>OTHER LIABILITIES</u>

As of January 1, 2003, the Company increased by approximately 12,700 to 34,000 the amount of square feet under lease in the same building of its US Headquarters. The term of the lease was also extended to 2009 and monthly lease payments increased from $50 thousand to $72 thousand. As an incentive for the Company to acquire the additional space, the lessor granted the Company $814 thousand in lease

Table of Contents

incentives that were used to pay for architectural fees, renovations and improvement costs for the new space. The lease incentives were capitalized as if the Company incurred the costs to make the improvements and are included in Property and Equipment. These assets and the related liability are amortized over the remaining life of the lease at a rate of approximately $116 thousand per year as an additional amortization expense and a reduction in rent expense, respectively. The accounting for these lease incentives has no impact on net income, stockholders equity or cash flow.

7. STOCKHOLDERS EQUITY

Share-Based Compensation

Effective January 1, 2006 we adopted SFAS No. 123R using the Modified Prospective Approach. SFAS No. 123R revises SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123) and supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25). SFAS No. 123R requires the cost of all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values at grant date, or the date of later modification, over the requisite service period. In addition, SFAS No. 123R requires unrecognized cost (based on the amounts previously disclosed in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized in the financial statements over the remaining requisite service period. Accordingly, prior period amounts have not been restated.

Under the Modified Prospective Approach, the amount of compensation expense recognized includes compensation expense for all share-based payments granted prior to, but not yet fully vested as of January 1, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123 and compensation expense for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123R. Prior to adoption of SFAS No. 123R, we determined share-based compensation expense by applying the intrinsic value method provided for in APB Opinion No. 25.

In the third quarter ended September 30, 2007, SFAS No. 123R resulted in incremental stock-based compensation expense of $67 thousand, or $0.00 on a basic and diluted earning per share basis. For the nine months ending September 30, 2007, the adoption of SFAS No. 123R resulted in incremental stock-based compensation expense of $240 thousand or $0.01 on a basic and diluted earning per share basis. The compensation expense associated with SFAS No. 123R did not have a net impact on cash flows from operating, investing or financing activities. A deduction is not allowed for income tax purposes until the options are exercised. The amount of the income tax deduction will be the difference between the fair value of the Company s common stock and the exercise price at the date of exercise. The tax effect of the income tax deduction in excess of the financial statement expense will be recorded as an increase in additional paid-in-capital. Accordingly, SFAS No. 123R requires the recognition of a deferred tax asset for the tax effect of the financial statement expense recorded. However, due to our recent loss history, and uncertainty regarding the realization of deferred tax assets, deferred tax assets have been fully reserved as of September 30, 2007. The net operating losses incurred to date by the Company are being carried forward and may be applied against future taxable income subject to certain limitations set forth in Section 382 of the Internal Revenue Code.

The Company has issued stock options to employees under share-based compensation plans. Stock options issued prior to January 1, 2007 were issued at the closing market price on the date of the grant, subject to a 3-year vesting period with a contractual term of 5 years. Stock options issued after January 1, 2007 were issued at the closing market price on the date of grant, subject to a 3-year vesting period with a

Table of Contents

contractual term of 10 years. The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of our common stock. We use historical data on exercises of stock options and other factors to estimate the expected life of the share-based payments granted. For options granted prior to January 1, 2006, we determined the expected life to be 5 years, and an expected life of 4 years for any options granted between January 1, 2006 and December 31, 2006. For options issued subsequent to January 1, 2007, we determined the expected life to be 7 years due to the adoption of a new stock option plan under which these shares were issued. The risk free rate is based on the U.S. Treasury bond rate commensurate with the expected life of the option.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Risk-free interest rate	4.45%	4.53% - 5.16%	4.45% - 4.81%	4.53% - 5.16%
Expected dividend yield				
Expected life	7 years	4 years	7 years	4 years
Expected volatility	61.97%	57.30%	63.60%	58.01%
Forfeiture rate	15.00%	15.68%	15.00%	15.68%

A summary of award activity under the stock option plans as of September 30, 2007 and changes during the three month period is presented below:

	Number of Shares	Weighted Average Exercise Price per Share	Intrinsic Value
Options outstanding at December 31, 2006	1,130,550	$ 2.53	$ 3,142,929
Granted	72,500	5.07	(163,125)
Exercised	(72,500)	2.95	9,425
Canceled	(24,000)	3.05	5,520
Options outstanding at March 31, 2007	1,106,550	$ 2.65	$ 188,114
Granted	9,000	3.69	(7,830)
Exercised	(39,200)	2.45	(14,504)
Canceled	(13,333)	3.96	15,200
Options outstanding at June 30, 2007	1,063,017	$ 2.65	$ 180,713
Granted	10,000	2.85	(300)
Exercised	(7,000)	2.31	(3,570)
Canceled	(47,250)	3.11	13,703
Options outstanding at September 30, 2007	1,018,767	$ 2.65	$ 173,190
Vested options outstanding at:			
September 30, 2007	660,019	$ 2.49	$ 217,806
Options expected to vest at			
September 30, 2007	304,936	$ 2.90	$ (24,395)

Table of Contents

Approximately 289,580 options, net of forfeitures, of the 304,936 options expected to vest as of September 30, 2007 will vest within the next year.

A summary of stock options expected to vest in the next twelve months is as follows:

	Options Expected To Vest Within 1 Year		
	Number of Shares	Weighted Average Remaining	Weighted Average Exercise
Range of Exercise Prices	Expected to Vest	Contractual Life in Years	Price Per Share
$2.00 - $2.50	253,581	2.75	2.25
2.51 - 3.00	7,000	6.65	2.85
3.01 - 3.50	1,833	4.01	3.13
3.51 - 4.00	11,333	9.51	3.73
4.01 - 4.50	2,500	9.42	4.10
$6.00 - 6.10	13,333	9.32	6.08
	289,580	3.48	2.52

As of September 30, 2007, there was $374 thousand of total unrecognized compensation cost related to unvested share-based compensation awards granted under the stock option plans. That cost is expected to be recognized over a weighted-average period of 2.07 years.

Based upon the above assumptions, the weighted average fair value of the stock options granted for the three months ended September 30, 2007 and 2006 was $1.85 and $1.46, respectively. Based upon the above assumptions, the weighted average fair value of the stock options granted for the nine months ended September 30, 2007 and 2006 was $3.11 and $1.22, respectively.

The Company has a policy of issuing new shares to satisfy share option exercises.

8. SUPPLEMENTAL CASH FLOW INFORMATION

No significant income tax payments were required for the nine months ended September 30, 2007 and 2006, respectively. Cash paid for interest for the nine months ended September 30, 2007 and 2006 was approximately $19 thousand and $4 thousand, respectively. In August 2007, we entered into a lease agreement for several pieces of office equipment that is being accounted for as a capital lease. The present value of capital lease obligation and the corresponding asset value of the equipment acquired was $150,597. We did not enter into any capital lease obligations during the three and nine months ended September 30, 2006. The Company issued shares of its Common Stock with a value of $2 million to the Remedium stockholders as additional consideration upon the attainment of certain revenue targets described in the Amended Agreement on March 27, 2007 (See Note 9).

9. ACQUISITION OF REMEDIUM OY

On November 1, 2006, Encorium Group, Inc. acquired Remedium Oy, a corporation organized under the laws of Finland (Remedium), in which the Company purchased all of the issued and outstanding shares of capital stock of Remedium (the Shares) pursuant to the Amended and Restated Combination Agreement dated July 6, 2006 (the Amended Agreement).

Table of Contents

The consideration paid at closing to Remedium s stockholders (the Stockholders) for the Shares consisted of (i) shares of Common Stock of the Company with a value of $11 million; and (ii) $2.5 million in cash. An additional cash payment of $1.5 million was paid to the Stockholders on March 30, 2007. Subject to certain purchase price adjustments, on the first anniversary of the closing of the Amended Agreement, the Company will issue to the Stockholders additional shares of Common Stock of the Company with a value of $2 million. The Company determined it is likely it will issue the additional shares of its Common Stock with a value of $2 million (i.e. 706,714 shares) on the anniversary of the Closing. Additional consideration of shares Common Stock of the Company with a value of $2 million was paid to the Remedium stockholders upon the attainment of certain revenue targets described in the Amended Agreement on March 27, 2007. This additional consideration was already included in our purchase price allocation.

Unaudited pro forma results of operations resulting from the acquisition of Remedium Oy would have been as follows for the three and nine months ended September 30, 2007 and 2006 if the business combination has occurred on January 1, 2006.

	Three Months Ended September 30,		Nine Months Ended September 30,	
		2006		2006
Net Revenue [(1)]	$	6,785,393	$	17,905,665
Net Loss	$	544,794	$	(44,929)
Loss per share - basic	$	0.04	$	(0.00)
Loss per share - diluted	$	0.04	$	(0.00)

(1) Excludes reimbursement revenue

10. GOODWILL AND OTHER INTANGIBLES

The Company followed the provisions of SFAS No. 141, *Business Combinations,* and SFAS No. 142, *Goodwill and Other Intangible Assets,* applicable to business combinations. The amount of Goodwill that resulted from the Remedium acquisition, including deferred taxes of $1.7 million, was $15.4 million. In accordance with SFAS No. 141 the amount of goodwill resulting from the Remedium acquisition was determined as the excess of cost over the fair values of acquired net assets. In accordance with these standards, goodwill acquired in connection with the acquisition of Remedium was not amortized. Under SFAS No. 142, goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If carrying value exceeds current fair value, then goodwill is considered impaired and is reduced to fair value via a charge to earnings. Should the goodwill become impaired, our consolidated earnings and net worth may be materially adversely affected. In addition, impairment testing involves the use of accounting estimates and assumptions, changes in which could materially impact our financial condition or operating performance if actual results differ from such estimates and assumptions.

The Company also acquired $6.5 million of identifiable intangible assets in connection with the Remedium acquisition. Of the $6.5 million of acquired intangible assets, $3.9 million was attributed to customer relationships, $2.6 million was attributable to backlog and $53 thousand was attributable to a non-compete agreement. All of these intangibles are subject to amortization on a straight-line basis. The estimated useful lives for customer relationships, backlog and non-compete agreement are 16 years, 18

Table of Contents

months and 4 years, respectively. Amortization expense was $1.5 million for the nine months ended September 30, 2007. As of September 30, 2007, the estimated amortization of intangibles expense to be recorded in future periods is as follows:

2007	$ 498,190
2008	834,410
2009	255,236
2010	253,009
2011	