COVALENT GROUP INC
Form 10-K
March 29, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005.

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

COVALENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**56-1668867**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One Glenhardie Corporate Center, 1275 Drummers Lane, Suite 100, Wayne, Pennsylvania	**19087**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 610-975-9533

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.001 Par Value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No þ

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of June 30, 2005, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $25,567,682 based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation System Market System.

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

Class	**Outstanding at March 1, 2006**
Common Stock, $.001 par value per share	13,501,333 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document
NONE

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COVALENT GROUP, INC.

FORM 10-K ANNUAL REPORT

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In this discussion, the terms Company, we, us and our refer to Covalent Group, Inc. and our consolidated subsidiaries, except where it is made clear otherwise.

FORWARD LOOKING STATEMENTS

When used in this Report on Form 10-K and in other public statements, both oral and written, by the Company and Company officers, the words estimate, project, expect, intend, believe, anticipate and similar expressions are intended to identify forward-looking statements regarding and trends that may affect our future operating results and financial position. Such statements are subject to risks and uncertainties that could cause our actual results and financial position to differ materially. Such factors include, among others: (i) our success in attracting new business and retaining existing clients and projects; (ii) the size, duration and timing of clinical trials; (iii) the termination, delay or cancellation of clinical trials; (iv) the timing difference between our receipt of contract milestone or scheduled payments and our incurring costs to manage these trials; (v) outsourcing trends in the pharmaceutical, biotechnology and medical device industries; (vi) the ability to maintain profit margins in a competitive marketplace; (vii) our ability to attract and retain qualified personnel; (viii) the sensitivity of our business to general economic conditions; and (ix) other economic, competitive, governmental and technological factors affecting our operations, markets, products, services and prices. We undertake no obligation to publicly release the result of any revision of these forward-looking statements to reflect events or circumstances after the date they are made or to reflect the occurrence of unanticipated events. Please refer to the section entitled Risk Factors that Might Affect our Business or Stock Price beginning on page 9 for a more complete discussion of factors which could cause our actual results and financial position to change.

PART I

ITEM 1. *BUSINESS*
General

In this discussion, the terms Company, we, us and our refer to Covalent Group, Inc. and our consolidated subsidiaries, except where it is made clear otherwise.

We are a clinical research organization (CRO) which is a leader in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. Our mission is to provide our clients with high quality, full-service support for their clinical trials. We offer therapeutic expertise, experienced team management and advanced technologies. Our headquarters is in Wayne, Pennsylvania and our International operations are based in London, England.

Our clients consist of many of the largest companies in the pharmaceutical, biotechnology and medical device industries. From protocol design and clinical program development, to proven patient recruitment, to managing the regulatory approval process, we have the resources to directly implement or manage Phase I through Phase IV clinical trials and to deliver clinical programs on time and within budget. We have clinical trial experience across a wide variety of therapeutic areas, such as cardiovascular, endocrinology/metabolism, diabetes, neurology, oncology, immunology, vaccines, infectious diseases, gastroenterology, dermatology, hepatology, womens health and respiratory medicine. We have the capacity and expertise to conduct clinical trials on a global basis.

We were initially incorporated in August 1998 in Nevada. In June 2002, we changed our state of incorporation to Delaware.

Industry Overview

The CRO industry provides independent clinical trial and product development services for the pharmaceutical, biotechnology and medical device industries. Companies in these industries often outsource product development services to CROs in order to manage the drug development process more efficiently and cost-effectively. Outsourcing also enables these companies to access expertise and experience beyond their organizations. Historically, many companies in the pharmaceutical, biotechnology and medical device industries have performed the majority of their product development internally. Outsourcing drug development activities to CROs provides these companies with a variable cost alternative to the fixed costs associated with internal drug development. Companies no longer need to staff for peak periods and can benefit from a CRO s technical resources, therapeutic expertise, and the global infrastructure required to conduct clinical trials on a worldwide basis.

At the present time, we believe that the percentage of services required for product development that are being outsourced is increasing and will continue to increase in the future because of numerous factors, including: cost containment pressures; attempts to overcome limitations on internal capacity; a desire to improve the timeline for evaluating and developing new drugs and/or devices; the desire to increase the percentage

of development costs that are variable as compared to fixed costs; the need to perform research relating to new drugs in multiple countries simultaneously; the response to increasingly

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stringent government regulations in various countries; and the desire to use external expertise to supplement internal design and development capabilities.

As the investment required to develop new drugs continues to increase, an opportunity is created to help speed the drug development process or make this process more efficient.

Our Strategy

Our strategy is to be a leader in the design and management of complex clinical trials by providing our clients with exceptional performance ensuring that they achieve their goals on-time, on-budget and with superlative quality. Our competitive advantage is based upon our ability to deliver a knowledge-based and intellectually rich level of service that provides our clients with a well-conceived protocol design and operational plan intended to maximize their return on investment. We believe that many of the reported regulatory delays or rejections for prospective drugs can be directly attributed to underlying issues in protocol design and development. Our Company is led by experienced executives with significant prior success in the drug development and regulatory approval process. Unlike larger, more conventional CROs, we provide a value-added approach to the design and management of clinical trials. We believe that our leadership in the design of complex clinical trials, our application of innovative technologies, our therapeutic expertise and our commitment to quality offer clients a means to more quickly and cost-effectively develop products through the clinical trial process.

A significant aspect of our strategy is to expand our geographic presence and add to our clinical development capabilities in existing new therapeutic areas or service offerings. In March 2006, we announced the signing of a Combination Agreement with Remedium OY (Remedium), a privately owned, full service CRO based in Espoo, Finland with offices in 8 countries throughout Scandinavia, Central Europe and Eastern Europe. Under the terms of the Agreement, we expect to pay approximately $20 million for all of the outstanding shares and common stock equivalents of Remedium. The consideration for the transaction is expected to be in the form of Company shares in the amount of $16 million and $4 million in cash, subject to certain purchase price adjustments. The closing of the transaction is expected to occur at the end of the second quarter of 2006 subject to certain contingencies including, but not limited to, the approval of our shareholders and a scheduled new fundraising for at least $4 million to help finance the transaction. In connection with the transaction, we plan to change our name to Encorium BioSolutions, Inc. and apply for a new ticker symbol in connection with our name change.

Once the Remedium transaction closes, we intend to manage all our current and future European and Asian clinical studies from Remedium s facility in Espoo, Finland. We intend to continue to manage our North American and South American clinical trial studies from our Wayne, Pennsylvania facility. Our worldwide headquarters will remain in Wayne, Pennsylvania.

A significant way to demonstrate our capabilities and attract new business is to showcase our prior success in managing complex clinical trials. In 2003, we experienced great success with the REVERSAL study. We were an instrumental part of the team that designed, wrote, and conducted the trial for Pfizer. The results of this landmark study, which showed for the first time that aggressive pharmacological therapy could stabilize or even regress coronary artery disease, were presented at the American Heart Association Scientific Sessions in November 2003 and subsequently published as the lead article in the Journal of the American Medical Association. The REVERSAL results have appeared on the front page of the New York Times as well as in the Wall Street Journal, USA Today, and Time Magazine. The results were also featured on MSNBC and CNN. It was a major success story for the Company and is a concrete example of what we can do from both an intellectual and operational perspective. In January 2005, a follow-up article that presented additional data from the REVERSAL study appeared as a lead article in the New England Journal of Medicine.

In 2004, we substantially completed the CAMELOT/NORMALISE study, which was conducted in North America and Europe. Two thousand patients with coronary artery disease and well controlled blood pressure were randomized to standard-of-care therapy plus either the calcium channel blocker Norvasc®, the angiotensin converting enzyme inhibitor Vasotec®, or placebo. After two years of follow-up, patients treated with active drug had a decrease in systolic blood pressure of 5.5 mmHg and a decrease in diastolic blood pressure of 3.0 mmHg. Administration of Norvasc® resulted in a highly significant 31% reduction in adverse cardiovascular events. Directionally similar but smaller and non-significant treatment effects were observed with Vasotec®. Intravascular ultrasound imaging of coronary artery atherosclerotic plaque showed evidence of slowing of atherosclerosis progression only with Norvasc®. The results of the CAMELOT/NORMALISE study have raised clinically relevant questions about how low the target blood pressure should be in patients with coronary artery disease. This issue is currently under intense review by physician groups charged with establishing blood pressure treatment guidelines for patients with coronary artery disease.

With our wholly-owned international subsidiary, Covalent Group, Ltd., we are able to meet many of the global drug development needs of our clients. In 2003, we formed strategic partnerships with several highly experienced regional CROs to broaden our geographic reach. These regional CROs share our vision and values, and are known to produce quality

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deliverables. They are based in Moscow, Russia, Sofia, Bulgaria, Sao Paulo, Brazil and Sydney, Australia regions that were specifically targeted because we believe they have or will achieve strategic prominence over the next several years with respect to clinical trials. Overall, these partnerships have substantially increased the number of operational personnel that we can employ on global trials and allow us to better service the needs of the pharmaceutical and biotechnology industries. These strategic partnerships also complement our proposed acquisition of Remedium since they are based in locations in which Remedium does not conduct major operations.

Recognizing the dynamic nature of the pharmaceutical and medical device development process, our experience and capabilities enables us to adapt our services to fit our clients specific needs. The distinguishing features of our services include the following:

Experienced Management. We are an established company led by a senior management team who average greater than 20 years of clinical research experience from both the CRO and pharmaceutical/biotechnology industry perspective. Our company includes 4 individuals who hold a Ph.D. or M.D. degree. For example, our President and Chief Executive Officer, Dr. Kenneth M. Borow, is a Harvard-trained physician with nearly 30 years of medical, academic and clinical trials experience at Merck, University of Chicago School of Medicine, Brigham and Women s Hospital, Boston Children s Hospital, and Covalent. Our Senior Vice President, Global Operations, Alison O Neill has worked in the pharmaceutical industry for 24 years, 18 of these in clinical research for both pharmaceutical and CRO employers.

Credibility in the clinical research marketplace. We have a strong client base with a high rate of repeat business. We have gained the confidence of our clients as demonstrated by their entrusting us with broad responsibilities, including designing and implementing global clinical research programs for some of their most important products. We provide leadership in a wide variety of therapeutic areas including cardiovascular, endocrinology/metabolism, diabetes, nephrology, immunology, vaccines, infectious diseases, gastroenterology, dermatology, hepatology, womens health, and respiratory medicine.

Global capabilities. In 2000, Covalent Group, Ltd., our wholly-owned international subsidiary, commenced operations, providing us with a strategically important international presence. Covalent Group, Ltd. has an international client base with their own clinical trials, but also assists us in conducting clinical trials in Western Europe, Eastern Europe, Scandinavia and elsewhere for our clients. During 2003, we established proprietary strategic partnerships with several highly experienced regional CROs in order to strengthen and broaden our global offerings and our geographic reach. We have made a very determined effort to broaden and diversify our client list. This has resulted in an attractive mix of pharmaceutical and biotechnology companies and we will continue to focus on expanding our capabilities both in the United States and internationally. We believe that these capabilities better positions us to meet our clients global clinical trial requirements. Once the proposed Remedium acquisition is completed, the management of our European and Asian operations will be based at Remedium s offices in Espoo, Finland.

Our bioterrorism vaccine program. During 2003 and 2004, we began the process of conducting a global Counter-Bioterrorism program focused on the development of vaccines against biological agents with potential military and terrorism applications. This program offers clients an inter-disciplinary group of clinical development professionals with extensive experience working with vaccines, recombinant technology and immunotherapy products. During 2005, we continued to win additional business focusing on the development of counter-bioterrorism vaccines for a new client. In total, we managed four separate clinical trials in 2005 in this particular therapeutic area.

Our Services

We offer our clients on a global basis a broad range of clinical research and development services supporting Phase I through Phase IV clinical trials. Our services include study protocol design, clinical trials management, global data management services, biostatistics, medical and regulatory affairs, and quality assurance and compliance.

Study Protocol Design

We specialize in complex clinical trials with a particular focus on understanding conceptual issues and creating practical solutions. Much of the conceptual value-added work focuses on the design of an effective development program which includes individual clinical trial protocols. The study protocol is the critical document provided to the study investigators that defines the study and details the procedures which must be followed for the proper conduct of the trial. The protocol defines the medical issues the study seeks to examine and the statistical tests that will be conducted. The protocol also defines the frequency and type of laboratory and clinical measurements to be performed, tracked and analyzed. Also defined is the number of patients required to produce a statistically meaningful result, the period of time over which they must be tracked, and the frequency and dosage of drug administration.

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A properly designed protocol targets the correct primary efficacy variable (i.e. the key outcome being studied, such as a reduction in sitting diastolic or systolic blood pressure), is statistically sound, effectively incorporates strategic marketing and product positioning issues, and proactively conforms to regulatory guidelines. We believe that many of the reported regulatory delays or rejections for prospective drugs can be directly attributed to underlying issues in protocol design and study process. A significant value we provide to our clients is in designing the initial study protocol or in significantly enhancing the protocol s design.

Clinical Trials Management

We serve our clients needs by conducting clinical trials through a project team. A project manager leads and facilitates all aspects of the conduct of the clinical trial. Other members of our project team typically include representatives from clinical trials management, global data services, regulatory affairs, information services, quality assurance, medical writing and field monitoring. Within this project-oriented structure, we can manage every aspect of clinical trials conducted in Phases I through Phase IV of the drug development process. Many of our current projects involve Phase II, Phase III or Phase IIIb clinical trials, which are generally larger, longer and more complex than Phase I trials.

We have adopted global standard operating procedures intended to satisfy global regulatory requirements and serve as tools for controlling and enhancing the quality of our clinical trials. All of our standard operating procedures are designed and maintained in compliance with Good Clinical Practice (GCP) requirements and the International Conference on Harmonization (ICH) standards. The U.S. Food and Drug Administration (FDA) and the European union have adopted these standards. We compile, analyze, interpret and submit data generated during clinical trials in report form to our clients, as well as, at our client s request, directly to the FDA or other relevant regulatory agencies for purposes of obtaining regulatory approval.

Clinical trials represent one of the most expensive and time-consuming parts of the overall drug development process. The information generated during these trials is critical for gaining marketing approval from the FDA or other regulatory agencies. We assist our clients with one or more of the following steps:

Case Report Form Design. Once the study protocol has been finalized, the Case Report Form (CRF) must be developed. The CRF is the document for collecting the necessary clinical data as defined by the study protocol. The CRF for a single patient in a study may consist of 100 or more pages.

Investigator Recruitment. The success of a clinical trial is dependent upon finding experienced investigators who are capable of performing clinical trials in accordance with the highest ethical and scientific standards. During clinical trials, physicians (who are also referred to as investigators) at hospitals, clinics or other locations, supervise administration of the drug or study product to patients or normal subjects. We recruit investigators who contract directly with either us or our clients to participate in clinical trials. Our global investigator database includes thousands of physician-investigators specializing in a multitude of therapeutic areas.

Patient Enrollment. The investigators find and enroll patients suitable for the study. The speed at which trials can be completed is significantly affected by the rate at which patients are enrolled. Prior to participating in a clinical trial, patients are required to review information about the study medication and its possible side effects, and sign an informed consent form to record their knowledge and acceptance of potential side effects. Patients also undergo a medical examination by the investigator to determine whether they meet the requirements of the study protocol. Patients then receive the study medication and are examined by the investigator as specified by the study protocol.

Study Monitoring and Data Collection. As patients are examined and tests are conducted in accordance with the study protocol, data is recorded on CRFs. CRFs are reviewed or monitored by specially trained clinical research associates or field monitors. Field monitors visit study sites regularly to ensure that the CRFs are completed correctly and that the data specified in the protocol are obtained. The field monitors send completed CRFs to a data management group where they are reviewed for consistency and accuracy before the data are entered into a database. An alternative data flow process utilizes remote data entry technology and a fax based system that frequently enhances the timeliness of clinical data collection while achieving cost savings to the Sponsor. We are currently involved in studies using both types of data flow processes.

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Data Management Services

We have automated the data management process associated with clinical trial management through our use and customization of industry standard software known as clinical trials management systems. We license Oracle Clinical® and Datafax as our clinical trials management systems. The software assists us in the collection, validation and reporting of clinical results to our clients. Our data management professionals provide CRF review and tracking, data entry, integrated clinical/statistical reports, as well as writing manuscripts for publication.

Biostatistics

Typically, biostatisticians assist clients with all phases of drug development, including biostatistical consulting, database design, data analysis and statistical reporting. These professionals help develop and review protocols, design appropriate analysis plans and design report formats to address the objectives of the study protocol, as well as the client s individual objectives. Frequently, we represent clients in meetings with the FDA regarding biostatistical consulting.

Medical and Regulatory Affairs

Typically, before a drug, biologic, or medical device can be sold in a particular country, it must be approved by the regulatory agency in that country. We provide comprehensive regulatory product registration services for pharmaceutical, biotechnology products and medical devices in the United States and Europe. These services include regulatory strategy formulation, New Drug Application (NDA) and Biologic License Application document preparation and review, quality assurance and liaison with the FDA and other regulatory agencies.

Quality Assurance and Compliance

We conduct field inspections that include investigator audits, pre-submission protocol compliance audits and GCP audits. Our staff also provides training sessions to our personnel, as well as to study site employees. Finally, our Quality Assurance and Compliance group performs audits of study documents as well as data contained in our clinical trials databases.

Report Writing

The statistical analysis findings for data collected during the trial, together with other clinical data, can be included in a final study report to be included in a regulatory filing or as a final deliverable to the client.

Patient Registries

Patient Registries are becoming an essential, emerging tactic for all brand marketers and therapeutic categories. They provide an opportunity to rapidly populate databases with real-world, patient-derived information that can be analyzed and disseminated in multiple formats. This has become particularly important considering the recent issues that have come to the forefront regarding long-term patient safety associated with FDA approved and commercially marketed drugs. Data collection, analysis and reporting requirements for Registries are significantly less stringent than for traditional phase IIIb and IV studies. Their success is independent of investigator experience. Therefore, a Registry is an ideal tool for reaching out to the primary care population in a clinically meaningful and credible way. In addition, Registries facilitate and improve relationship building between biopharmaceutical companies and regional/local opinion leaders and high volume providers. They increase access to these important community based physicians while creating a credible, necessary, real-world decision database that provides multiple patient safety, commercialization, communication and education opportunities for stakeholders in the healthcare environment.

Clients and Marketing

We provide a broad range of clinical research and consulting services to the pharmaceutical, biotechnology and medical device industries. Our clients consist of many of the largest companies in the pharmaceutical, biotechnology and medical device industries. In 2005, we provided services to 23 different clients covering 41 separate studies or projects. We have in the past derived, and may in the future derive, a significant portion of our revenues from a core group of major clients. We are likely to continue to experience client concentration in future years. In 2005, our three largest clients accounted for 70 % of our net revenues, with the three largest representing 27%, 26% and 17% of our net revenues, respectively. In 2004, our three largest clients accounted for 57% of our net revenues, with the three largest representing 23%, 19% and 15% of our net revenues, respectively. In 2003, our three largest clients accounted for 69% of our net revenues, with the three largest representing 41%, 21%, and 7%, respectively. Our largest clients for any one year period may not represent the same customers as in a prior year period.

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We are generally awarded contracts based upon our response to requests for proposals received from pharmaceutical, biotechnology and medical device companies. Our business development and marketing strategy is based on expanding our relationships with our existing clients as well as gaining new clients. Our senior executives and project team leaders all share responsibility for maintaining and enhancing client relationships and business development activities. Our business development program is supported by a marketing and communications program that includes selective advertising in trade publications, management of the corporate web site, development of marketing materials, and related activities.

Contractual Arrangements

Most of our contracts with our clients are based on a fixed price with the option for additional variable components (i.e. change of scope). Therefore, we generally bear the risk of cost overruns, but we may also benefit if the costs are lower than we anticipated. Contracts may range from a few months to several years depending on the nature of the work performed. In general, for multi-year contracts, a portion of the contract fee, typically 10-15%, is paid at the time the trial is started, with the balance of the contract fee payable in installments over the trial duration. In some cases, the installments are tied to meeting specific performance milestones, while others have an agreed upon fixed payment plan independent of performance milestones. For example, installment payments for clinical trial projects may be related to investigator recruitment or patient enrollment. Several of our older contracts contain payment schedules that are weighted towards the later stages of the contract. As is typical in the CRO industry, when a client requests a change in the scope of a trial or in the services to be provided by us, we prepare a work order. An executed work order becomes an amendment to the original contract. Work orders resulting from changes of scope often produce additional revenue for us. We are at risk for any work performed outside the scope of the study or in advance of signing a new work order. We attempt to negotiate contract amendments with the client to cover any services provided outside the terms of the original contract. There can be no assurance that the client will agree to the proposed amendments, and we ultimately bear the risk of cost overruns.

Most of our contracts may be terminated by the client at any time with prior notice. Our contracts frequently entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination. Contracts may be terminated or delayed for several reasons, including unexpected results or adverse patient reactions to the drug, inadequate patient enrollment or investigator recruitment, manufacturing problems resulting in shortages of the drug, budget constraints of clients or decisions by the client to de-emphasize or terminate a particular trial, development efforts on a particular drug, or our failure to properly perform our obligations.

Backlog

Our backlog consists of anticipated net revenue from uncompleted projects which have been authorized by the client, through a written contract, verbal commitment or letter of intent. Many of our studies and projects are performed over an extended period of time, which may be several years. Amounts included in backlog have not yet been recognized as net revenue in our consolidated statements of operations. Once contracted work begins, net revenue is recognized over the life of the contract on a proportional performance basis. The recognition of net revenue reduces our backlog while the awarding of new business increases our backlog. In 2005, we obtained $19.1 million of new business awards as compared to $21.5 million in 2004, an 11% decrease. Our backlog was $22.7 million at December 31, 2005, compared to $15 million at December 31, 2004. We expect most of this backlog will be recognized in 2006 subject to the risk factors listed herein.

We believe that our backlog as of any date may not necessarily be a meaningful predictor of future results because backlog can be affected by a number of factors including the size and duration of contracts, many of which are performed over several years. Additionally, contracts may be subject to early termination by the client or delay for many reasons, as described above. Also, the scope of a contract can change during the course of a study. For these reasons, we might not be able to fully realize our entire backlog as net revenue.

Competition

The contract research organization industry is highly fragmented, consisting of several hundred small, limited-service providers and a limited number of mid-sized and large CROs with global capabilities.

Newer, smaller firms with specialty focuses, such as those aligned with a specific disease or therapeutic area, may compete against established CROs for clients. We primarily compete against full-service and limited service contract research organizations, mid-sized CROs, in-house research and development departments of pharmaceutical and biotechnology companies and, to a lesser extent, universities and teaching hospitals. CROs generally compete on the basis of a number of factors, including the following: expertise and experience in specific therapeutic areas; the ability to design sound protocols or enhance the design; reputation for on-time quality performance; scope of service offerings; price; ability to enroll patients and recruit investigators; data management capabilities; strengths in various geographic markets; technological expertise and

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efficient drug development processes; the ability to acquire, process, analyze and report data in a timely and accurate manner; the ability to manage large-scale clinical trials both domestically and internationally; and organizational size. Although there can be no assurance that we will continue to do so, we believe that we compete favorably in these areas.

Some of our largest competitors include Quintiles Transnational Corporation, Covance, Inc., Parexel International Corporation, Pharmaceutical Product Development, Inc., Icon Clinical Research and Kendle International, Inc. In general, the CRO industry is not capital-intensive and the financial costs of entry into the industry are relatively low. Newer, smaller entities with specialty focuses, such as those aligned to a specific disease or therapeutic area, may compete aggressively against us for clients. Furthermore, clients may also choose to limit the CROs with whom they are willing to work. Increased competition might lead to heightened price and other forms of competition that may adversely affect our operating results.

Government Regulation

The development and clinical research of new drugs is highly regulated by government agencies. The standards for the conduct of clinical research and development studies are embodied in governmental regulations and in guidelines such as the ICH s Guideline on GCP. The standards stipulate procedures designed to ensure the quality and integrity of data obtained from clinical testing and to protect the rights and safety of clinical subjects. The FDA and similar regulatory authorities require that test results submitted to such authorities be based on studies conducted in accordance with GCP and regulations providing protections for research participants.

Our obligations under GCP may include, but are not limited to, the following: assuring the selection of investigators who are qualified and have adequate staff and facilities to conduct the trial properly and safely; obtaining specific written commitments from the investigators; verifying that adequate informed consent of trial subjects has been obtained; monitoring clinical trials to ensure that the rights and well-being of trial subjects are protected and that the reported trial data are accurate, complete, and verifiable from source documents; ensuring that adverse drug reactions are medically evaluated and reported; verifying drug or device accountability; implementing quality assurance and quality control systems; instructing investigators and study staff to maintain proper records and reports; and permitting appropriate governmental authorities access to source documents for their review. We must also maintain reports for each study for specified periods for auditing by the study sponsor and by the FDA or similar regulatory authorities. Noncompliance with GCP can result in disqualification of the data collected during the clinical trial and we could be required to redo the trial under the terms of our contract at no further cost to our client, but at substantial cost to us. CROs are also typically contractually obligated to comply with GCP and other patient protection regulations. Failure to comply could expose the CRO to contractual liability to its clients.

Development of New Drugs

Before a new drug may be marketed, the drug must undergo extensive testing and regulatory review in order to determine that the drug is safe and effective. The following discussion focuses on the FDA approval process. Similar procedures must be followed for clinical trials in other countries as well as for the approval of biologics and medical devices. The following provides a broad summary of the stages of this development process:

Preclinical research (1 to 4 years). This phase includes in vitro (test tube) and animal studies to establish the relative toxicity of the drug over a wide range of doses and to detect any potential to cause any serious adverse effects. If results warrant continuing development of the drug, the sponsor of the drug will file for an Investigational New Drug Application, upon which the FDA may grant permission to begin human clinical trials.

Clinical Trials (4 to 6 years).

Phase I (6 months to 2 years). Phase I includes basic safety and pharmacology testing in approximately 20 to 80 human subjects, usually healthy volunteers. Phase I work also includes studies to determine metabolic and pharmacologic action of the drug in humans, if it is safe, how it is affected by other drugs, where it goes in the body, how long it remains active, and how it is broken down and eliminated from the body.

Phase II (1 to 2 years). Phase II trials test basic efficacy (effectiveness) and potential dosing ranges in approximately 100 to 200 patients afflicted with the specific disease or condition for which the study medication is intended for use. Phase II trials help to determine the best effective dose, determine frequency of dosing, establish that the study medication has at least some effect, and provide additional safety data. If the Phase II study yields satisfactory results and no hold is placed by the FDA on further studies, a Phase III study of the drug may begin.

Phase III (2 to 4 years). Phase III trials are larger, more complex and more expensive than earlier phase studies and involve properly powered efficacy and safety evaluations in hundreds to thousands of patients afflicted with

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a specific disease or condition. These patients receive their medical care during the clinical trials at investigational sites, typically hospitals, clinics, or private practice settings. The objective of the Phase III study is to collect enough data for a statistically valid test of safety and effectiveness as required by the FDA, and to provide a basis for the labeling of the drug. The studies may be placebo-controlled trials, in which the study medication under investigation is compared with a sugar pill, or active-comparator studies that test the safety and effectiveness of the study medication against one or more drugs with established safety and efficacy profiles in the same therapeutic category.

The FDA receives reports on the progress of each phase of clinical testing and may require the modification, suspension, or termination of clinical trials if, among other things, an unreasonable risk is presented to patients or if the design of the trial is insufficient to meet its stated objective.

NDA Preparation and Submission. Upon the completion of the Phase III trials, the sponsor of the study medication assembles the statistically analyzed data from all phases of development into a single large submission: the NDA. An NDA may be submitted as a paper document (which may contain tens of thousands of pages) or in an electronic format.

FDA Review and Approval (approximately 12 months). The staff of the FDA will carefully scrutinize the data from all phases of development to confirm that the applicant has complied with regulations and that the drug is safe and effective for the specific use or indication under study. The FDA may refuse to accept the NDA for filing and substantive review if certain administrative and content criteria are not satisfied. After accepting the submission for review, the FDA may require additional testing or information before approval of an NDA. The FDA will deny approval of the NDA if applicable regulatory requirements are not ultimately satisfied.

Post-Marketing Surveillance and Phase IV Studies. Federal regulation requires the marketer of the drug to collect and periodically report to the FDA additional safety and efficacy data on the drug for as long as the drug is marketed (post-marketing surveillance). If the drug is marketed outside the United States, the reports must include data from all countries in which the drug is sold. Phase IV (post-FDA approval) studies may be undertaken after initial approval to find new uses for the drug (broadening the label), to test new dosage formulations, or to confirm selected non-clinical benefits (e.g. increased cost-effectiveness or improved quality of life). Product approval may be withdrawn if compliance with regulatory standards is not maintained or if problems occur following initial marketing.

In providing our clinical research services to our clients, we are obligated to comply with regulatory requirements governing the drug development process. We have established standard operating procedures that are designed to comply with regulations and guidelines appropriate to the region and the nation where the clinical trials will be conducted. We strive to perform all clinical research in accordance with the GCP and ICH guidelines and the requirements of the applicable country. From an international perspective, we have implemented common standard operating procedures across regions to assure consistency wherever appropriate to do so.

Intellectual Property

We have developed certain computer software and technically derived procedures that provide separate services and are intended to maximize the quality and effectiveness of our services. Our intellectual property rights are important to us. We also believe that factors such as technical expertise, knowledge, ability and experience of our professionals are important and provide significant benefits to our clients.

Potential Liability and Insurance

We contract with physicians who serve as investigators in conducting clinical trials to test new drugs on their patients. Such testing creates a risk of liability for personal injury to or death of the patients, resulting from adverse reactions to the drugs administered. In addition, although the Company does not believe it is legally accountable for the medical care rendered by third party investigators, it is possible that we could be subject to claims and expenses arising from any professional malpractice of the investigators with whom we contract with. We also may be held liable for errors and omissions in connection with the services we perform.

We believe that the risk of liability to patients in clinical trials is mitigated by various regulatory requirements, including the role of institutional review boards (IRBs) and the need to obtain each patient s informed consent. The FDA requires each human clinical trial to be reviewed and approved by the IRB at each study site. An IRB is an independent committee that includes both medical and non-medical personnel and is obligated to protect the interests of patients enrolled in the trial.

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After the trial begins, the IRB monitors the protocol and measures designed to protect patients, such as the requirement to obtain informed consent.

We attempt to reduce our risk through contractual indemnification provisions with clients and investigators, insurance maintained by clients, investigators and us, and various regulatory requirements, including the use of IRBs and the procurement of each patient s informed consent to participate in the study. However, the contractual indemnifications generally do not protect us against certain of our own actions such as negligence. In addition, the terms and scope of such indemnification vary from client to client and from trial to trial and the financial performance of these indemnities is not secured. Therefore, we bear the risk that the indemnity may not be sufficient or that the indemnifying party may not have the financial ability to fulfill its indemnification obligations. We maintain worldwide professional liability insurance. We believe that our professional liability insurance coverage is adequate. There can be no assurance, however, that we will be able to maintain such insurance coverage on terms acceptable to us, if at all. Our operating results and financial position could be materially and adversely affected if we were required to pay damages or bear the costs of defending any claim outside the scope of or in excess of a contractual indemnification provision or beyond the level of insurance coverage in the event that an indemnifying party does not fulfill its indemnification obligations.

Employees

At December 31, 2005, we employed 82 full time and 2 part time personnel, of which 9 were based outside of the United States. Of our staff, 4 held Ph.D. or M.D. degrees and approximately 14 held masters or other post graduate degrees. None of our employees are subject to a collective bargaining agreement. We believe that our relations with our employees are good. In addition, during 2005, we supplemented our employee base with contractors on an as-needed basis.

Risk Factors that Might Affect our Business or Stock Price

Failure to develop new business in our intensely competitive industry will cause our revenues to decline.

The market for contract research services is highly competitive. We primarily compete against in-house departments of pharmaceutical, biotechnology and medical device companies and other contract research organizations. Competitors in our industry range from small, limited-service providers to full service, global contract research organizations. Many of our competitors have an established global presence, including Quintiles Transnational Corp., Covance, Inc., Parexel International Corporation, Pharmaceutical Product Development, Inc., Icon Clinical Research, and Kendle International, Inc. These competitors have substantially greater financial and other resources than we do. Significant factors in determining whether we will be able to compete successfully include: our consultative and clinical trials design capabilities; our reputation for on-time quality performance; our expertise and experience in specific therapeutic areas; the scope of our service offerings; our ability to recruit investigators and study subjects in a timely manner; our strength in various geographic markets; the price of our services; our ability to acquire, process, analyze and report data in a time-saving and accurate manner; our global data services capabilities; our ability to manage large-scale clinical trials both domestically and internationally; and our size.

If our services are not competitive based on these or other factors and we are unable to develop an adequate level of new business, our business, backlog position, financial condition and results of operations will be materially and adversely affected. In addition, we may compete for fewer clients arising out of consolidation within the pharmaceutical industry and the growing tendency of drug companies to outsource to a smaller number of preferred contract research organizations.

Our services may from time to time experience periods of increased price competition that could have a material adverse effect on our profitability and revenues. Additionally, the CRO industry is not highly capital-intensive, and the financial costs of entry into the industry are relatively low. Therefore, as a general matter, the industry has few barriers to entry. Newer, smaller entities with specialty focuses, such as those aligned to a specific disease or therapeutic area, may compete aggressively against us for clients.

We depend on a small number of industries and clients for our business, and the loss of one of our significant clients could cause revenues to drop quickly and unexpectedly.

We provide services to the pharmaceutical, biotechnology and medical device industries and our revenue is highly dependent on expenditures by clients in these industries. Our operations could be materially and adversely affected if:

our clients reduce their research and development expenditures or reduce the rate of growth in their research and development expenditures;

consolidation in the pharmaceutical, biotechnology or medical device industries leads to a smaller client base for us;

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one or more significant studies are terminated as a result of the failure of the product to satisfy safety requirements, unexpected or undesired clinical results, or other reasons; or

our clients businesses experience financial problems or are affected by a general economic downturn.

Three of our clients account for a significant percentage of our revenues. For the year ended December 31, 2005, net revenues from our three largest clients amounted to 70% of our net revenues, with the three largest clients representing 27%, 26% and 17% of net revenues, respectively. For the year ended December 31, 2004, net revenues from our three largest clients amounted to 57% of our net revenues, with the three largest clients representing 23%, 19%, and 15% of net revenues, respectively. For the year ended December 31, 2003, net revenues from our three largest clients amounted to 69% of our net revenues, with the three largest clients representing 41%, 21%, and 7% of net revenues, respectively. We expect that a relatively small number of clients will continue to represent a significant percentage of our net revenue although our largest clients from year to year vary. Our contracts with these clients generally can be terminated on short notice. The loss of business from any one of these significant clients or our failure to continue to obtain new business would have a material and adverse effect on our business and revenues.

Loss of key personnel, or failure to attract and retain additional personnel, may cause the success and growth of our business to suffer.

Our future success depends on the personal efforts and abilities of the principal members of our senior management and scientific team to provide strategic direction, develop business, provide service to our clients, manage our operations and finances, and maintain a cohesive and stable environment. The loss of their services might significantly delay or prevent the achievement of business development and strategic objectives. As a provider of complex clinical trial support services, our success depends on our ability to retain key employees and to attract additional qualified employees. Competition for qualified personnel is intense and we cannot assure you that we will be able to retain existing personnel or attract and retain additional highly qualified employees in the future. Specifically, we are substantially dependent upon the efforts of Kenneth M. Borow, M.D., our President and Chief Executive Officer and Alison O Neill, our Senior Vice President, Global Operations. We have an employment agreement with Dr. Borow which expires on March 31, 2006. We currently do not have an employment agreement with Ms. O Neill. The loss of services of any of our key executives would have a material and adverse affect on our business operations, results of operations and financial position.

Competition for our key executives and skilled personnel, particularly those with a medical degree, a Ph.D. or equivalent degrees, is intense. We compete with contract research organizations, pharmaceutical and biotechnology companies, and academic and research institutions with far greater financial resources to recruit skilled personnel. Our inability to attract and retain qualified executives and scientific staff could have a material and adverse affect on our business plan, results of operations and financial condition. There can be no assurance that we will be able to continue to attract and retain qualified executives and scientific staff in the future.

The fixed price nature of the Company s contracts could have a negative impact on our operating results.

The majority of our contracts are at fixed prices. As a result, we bear the risk of cost overruns. If we fail to adequately price our contracts, fail to effectively estimate the cost to complete contracts, or if we experience significant cost overruns, our operating results and financial condition could be materially and adversely affected. In 2003 and 2004, we had to commit unanticipated resources to complete projects, resulting in higher costs and lower operating margins on those projects. During 2005, we experienced no significant cost overruns on our fixed price contracts. The Company attempts to negotiate contract amendments with the sponsor to cover services provided outside the terms of the contract. However, there can be no guarantee that the sponsor will agree to proposed amendments, and the Company ultimately bears the risk of cost overruns. We might experience similar situations in the future, which would have a material and adverse impact on our operating results and financial condition.

We may bear financial losses because our contracts may be delayed or terminated or reduced in scope for reasons beyond our control.

As described in our discussion of contractual arrangements in the description of our business, our contracts generally may be terminated or reduced in scope either immediately or upon notice. Clients may terminate or delay their contracts for a variety of reasons, including, but not limited to: the failure of products to satisfy safety requirements; unexpected or undesired clinical results; merger or potential merger related activities; the client s budget constraints; the client s decision to terminate the development of a particular product or to end a particular study; insufficient patient enrollment in a study; insufficient investigator recruitment; manufacturing problems resulting in shortages of the product; or our failure to perform our obligations under the contract. This risk of loss or delay of contracts potentially has greater effect as we pursue larger

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outsourcing arrangements with global pharmaceutical companies. Also, over the past several years we have observed that clients may be more willing to delay, cancel or reduce contracts more rapidly than in the past. If this trend continues, it could become more difficult for us to balance our resources with demands for our services and our financial results could be adversely affected.

In addition, companies may proceed with fewer clinical trials or conduct them without assistance of contract research organizations as a result of changing priorities or other internal considerations. These factors may cause such companies to cancel contracts with CROs.

In general, our contracts entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination. The loss, reduction in scope or delay of a significant contract or the loss or delay of multiple contracts could materially and adversely affect our business, results of operations and financial condition.

If we are unable to attract suitable willing volunteers for the clinical trials of our clients, our results could be materially and adversely affected.

One of the factors on which we compete is the ability to recruit independent investigators who can identify volunteers for the clinical studies we manage on behalf of our clients. These clinical trials rely upon the ready accessibility and willing participation of volunteer subjects. These subjects generally include volunteers from the communities in which the studies are conducted, which to date have provided an adequate pool of potential subjects for research studies. Many of our contracts include specific milestone payments directly tied to the recruitment of study subjects. The trials we manage and our operating results could be materially and adversely affected if we are unable to attract suitable and willing volunteers on a consistent basis.

Our drug or biologics development programs could result in potential liability to us.

We also contract with physicians to serve as investigators in conducting clinical trials. Such testing creates risk of liability for personal injury to or death of volunteers, particularly to volunteers with life-threatening illnesses, resulting from adverse reactions to the drugs administered during testing. It is possible third parties could claim that we should be held liable for losses arising from any professional malpractice of the investigators with whom we contract or in the event of personal injury to or death of persons participating in clinical trials. We do not believe we are legally accountable for the medical care rendered by third party investigators, and we would vigorously defend any such claims. However, such claims may still be brought against us requiring us to incur legal defense costs, and it is possible we could be found liable for these types of losses.

Changes in outsourcing trends in the pharmaceutical and biotechnology industries could materially and adversely affect our operating results and growth rate.

Industry trends and economic factors that affect our clients in the pharmaceutical, biotechnology and medical device industries also affect our business. Our revenues depend greatly on the expenditures made by the pharmaceutical, biotechnology and medical device industries in research and development. The practice of many companies in these industries has been to hire outside organizations like us to conduct clinical research projects. This practice has grown significantly in the last decade, and we have benefited from this trend. However, if this trend were to change and companies in these industries were to reduce the number of research and development projects they outsource, our business could be materially and adversely affected. For example, over the past year, mergers and other factors in the pharmaceutical industry appear to have slowed decision-making by pharmaceutical companies and delayed drug development projects. The continuation of or increase of these trends could have a negative affect on our business.

Additionally, numerous governments and managed care organizations have undertaken efforts to control growing healthcare costs through legislation, regulation and voluntary agreements with medical care providers and pharmaceutical companies. If future regulatory cost containment efforts limit the profits that can be derived on new drugs, our clients might reduce their research and development spending, which could reduce our business.

Failure to comply with existing regulations could harm our reputation and our operating results.

Any failure on our part to comply with applicable regulations could result in the termination of on-going clinical research or the disqualification of data for submission to regulatory authorities. For example, if we were to fail to verify that patient participants were fully informed and have fully consented to a particular clinical trial, the data collected from that trial could be disqualified. If this were to happen, we could be contractually required to repeat the trial at no further cost to our client, but at a substantial cost to us. The issuance of a notice from the FDA based upon a finding of a material violation by us of GCP requirements could result in contractual liability to our clients and/or the termination of ongoing studies which could

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materially and adversely affect our results of operations. Furthermore, our reputation and prospects for future work could be materially and adversely diminished.

Our backlog may not be indicative of future results.

As of December 31, 2005, our backlog was $22.7 million. The backlog represents anticipated net revenue from uncompleted projects with our clients. We cannot be certain that the backlog we have reported will be indicative of our future results. A number of factors may affect our backlog, including: the ability of clients to reduce or expand the size and duration of the projects (some are performed over several years); the termination or delay of projects; and a change in the scope of work during the course of a project.

Also, if clients delay projects, the projects will remain in backlog, but will not generate revenue at the rate originally expected. Accordingly, historical indications of the relationship of backlog to revenues may not be indicative of future results.

If we are unable to successfully develop and market new services in the U.S. and internationally, our results could be materially and adversely affected.

An element of our growth strategy is the successful development and marketing of new services that complement or expand our existing business. If we are unable to develop new services and create demand for those newly developed services, we may not be able to implement this element of our growth strategy, and our future business, results of operations and financial condition could be materially and adversely affected. For example, we have invested in the creation and administrative set-up of our wholly-owned international subsidiary, Covalent Group, Ltd. which has sustained operating losses to date. We may need to make additional investments in this subsidiary in the future in order for it to achieve our objectives. The profitability of this subsidiary depends, in part, on client acceptance and use of its services. There can be no assurance that this subsidiary will be profitable in the future or that any revenue resulting from it will be sufficient to recover our investment in the subsidiary. If our international subsidiary does not develop as anticipated, our business, financial condition and results of operations may be materially and adversely affected.

Changes in governmental regulation could reduce the need for the services we provide, which would negatively affect our future business opportunities.

In recent years the United States Congress and state legislatures have considered various types of health care reform in order to control growing health care costs. The United States Congress and state legislatures may again address health care reform in the future. We are unable to predict what legislative proposals will be adopted in the future, if any. Similar reform movements have occurred in Europe and Asia.

Implementation of health care reform legislation that results in additional costs to develop new drugs could limit the profits that can be made by our clients from the development of new products. This could adversely affect our clients research and development expenditures, which could in turn decrease the business opportunities available to us both in the United States and elsewhere in the world. In addition, new laws or regulations may create a risk of liability, increase our costs or limit our service offerings. We cannot predict the likelihood of any of these events.

Governmental agencies throughout the world, but particularly in the U.S., strictly regulate the drug development and approval process. Our business involves helping pharmaceutical, biotechnology and medical device companies navigate the regulatory drug approval process. Any changes in drug approval regulatory requirements such as the introduction of simplified drug approval procedures or an increase in regulatory requirements that we have difficulty satisfying, could eliminate or substantially reduce the need for our services. These and other changes in regulation could have an impact on the business opportunities available to us. As a result, our business, results of operations and financial condition could be materially and adversely affected.

Proposed and future laws and regulations, including the confidentiality of patient information, might increase the cost of our business, increase our risks of liability or limit our service offerings.

Federal or state authorities might adopt healthcare legislation or regulations that are more burdensome than existing regulations. These changes in regulation could increase our expenses or limit our ability to offer some of our products or services. For example, the confidentiality of patient specific information and the circumstances under which it may be released for inclusion in our databases or used in other aspects of our business are subject to substantial government regulation. Additional legislation governing the possession, use and dissemination of medical record information and other personal health information has been proposed at both the state and national levels. Proposed federal regulations governing patient specific health information might require us to implement new security measures that require substantial expenditures or limit our ability to offer some of our products and services. These regulations might also increase our costs by creating

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new privacy requirements and mandating additional privacy procedures for our business, thereby materially and adversely affecting our results of operations and financial condition.

Our operating results have fluctuated between quarters and years and may continue to fluctuate in the future.

Our quarterly and annual operating results have varied, and will continue to vary as a result of a variety of factors, many of which are beyond our control. Factors that may cause these variations include: the commencement, postponement, completion or cancellation of large contracts; the progress of on-going projects; changes in the mix of services offered; our ability to successfully negotiate contract amendments in a timely manner; and the timing and amount of start-up costs incurred in connection with the introduction of new products, services or subsidiaries.

A significant percentage of our operating costs are fixed. The timing of the completion, delay or loss of contracts, or the progress of client projects, can cause our operating results to vary substantially between reporting periods. We had an accumulated deficit of $5,418,116 and $3,933,377 as of December 31, 2005 and 2004, respectively, versus positive retained earnings of $289,918 for the year ended December 31, 2003. We believe that operating results for any particular quarter are not necessarily a meaningful indication of future results. While fluctuations in our quarterly or annual operating results could negatively impact the market price of our common stock, these fluctuations may not be related to our future overall operating performance.

Our operations may be interrupted by the occurrence of a natural disaster or other catastrophic event.

We depend upon our clients, study sites and our facilities, as well as the ability to readily travel among these, for the continued operation of our business. We also depend upon the continuous, effective, reliable and secure operation of our computer hardware, software, networks, telecommunications networks, Internet servers and related infrastructure. We have contingency plans in effect for natural disasters or other catastrophic events. However, catastrophic events, including terrorist attacks, could still disrupt our operations, those of our clients or study sites, or our ability to travel among these locations, which would also affect us. Although we carry business interruption insurance, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies. Any natural disaster or catastrophic event affecting our facilities could have a material and adverse affect on our business and results of operations.

We may have exposure to substantial personal injury claims and may not have adequate insurance to cover such claims.

Our business primarily involves the testing of experimental drugs and biologics or other regulated FDA products on consenting human volunteers pursuant to a study protocol. These tests create a risk of liability for personal injury to or death of volunteers resulting from negative reactions to the drugs administered or from improper care provided by third party investigators, particularly to volunteers with life-threatening illnesses. In connection with many clinical trials, we contract with physicians to serve as investigators in conducting clinical trials to test new drugs on human volunteers. We do not believe that we are legally accountable for the medical care rendered by third party investigators, and we seek to limit our liability with our clients, third party investigators and others. Although our contracts with clients generally include indemnity provisions and we have loss insurance, our financial condition and results of operations could be materially and adversely affected if we had to pay damages or incur defense costs in connection with a claim that is outside the scope of an indemnity or insurance coverage. Additionally, our financial condition could be adversely affected if our liability exceeds the amount of our insurance.

We believe that our risks are generally reduced by the following: contracts with our clients and, where applicable, investigators containing provisions entitling us to be indemnified by them; insurance maintained by our clients, investigators, where applicable, and by us; and various regulatory requirements we must follow in connection with our business.

Contractual indemnifications generally do not protect us against liability arising from certain of our own actions, such as negligence. Our financial condition and results of operations could be materially and adversely affected if we were required to pay damages or bear the cost of defending any claim which is not covered by a contractual indemnification provision, in the event that a party who must indemnify us does not fulfill its indemnification obligations or which is beyond the level of our insurance coverage. In addition, we may not be able to continue to maintain adequate insurance coverage on terms acceptable to us.

Our success depends on our ability to keep pace with rapid technological changes that could make our products and services less competitive or obsolete.

The clinical research aspects of the pharmaceutical, biotechnology and medical device industries are subject to increasingly rapid technological changes. Our competitors or others might develop technologies, products or services that are more effective or commercially attractive than our current or future technologies, products or services, or render our technologies,

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products or services less competitive or obsolete. For example, if our proprietary technology systems were to become less competitive or obsolete, our ability to develop new business and our operating results would be adversely affected. If competitors introduce superior technologies, products or services and we cannot make enhancements to our technologies, products and services necessary for us to remain competitive, our competitive position, and in turn our business, results of operations and financial condition, would be materially and adversely affected.

Our revenues and earnings are exposed to exchange rate fluctuations as well as international economic, political and other risks.

In 2005, approximately 7% of our net revenues were derived from contracts denominated in currencies other than U.S. dollars. Our financial statements are denominated in U.S. dollars. As a result, factors associated with international operations, including changes in foreign currency exchange rates, could affect our results of operations and financial condition.

We offer many of our services on a worldwide basis and we are therefore subject to risks associated with doing business internationally. We anticipate that net revenues from international operations may grow in the future and represent a greater percentage of total net revenues. As a result, our future results could be negatively affected by a variety of factors, including: changes in a specific country s political or economic conditions; potential negative consequences from changes in tax laws; difficulty in staffing and managing widespread operations; and unfavorable labor regulations applicable to our international operations.

The Remedium acquisition could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our business.

In March 2006, we announced the planned acquisition of Remedium OY, a privately held CRO based in Espoo, Finland. If we close the Remedium acquisition as expected, we would need to integrate the acquisition into our business operations. In doing so, we may face difficulties in coordinating and assimilating geographically separate units or organizations and integrating, motivating and retaining personnel with diverse business backgrounds. Further, we may not be able to successfully implement appropriate operational, financial and management systems and controls to achieve the anticipated benefits from the acquisition. In addition, our ability to integrate the Remedium acquisition could be affected by factors beyond our control, including regulatory developments, general economic conditions, and increased competition. The integration of the Remedium acquisition may also result in disruption to our existing business and the loss of existing key personnel and clients, or the loss of the acquired business key personnel or clients.

The occurrence of one or more of the above, or other factors, may adversely affect our ability to achieve the benefits anticipated from the Remedium acquisition. As a result, our financial condition and results of operations may be materially and adversely affected since the Remedium acquisition may not achieve the revenue growth and profitability expected.

Our stock price may be volatile and could experience substantial declines.

The market price of our common stock has experienced historical volatility and might continue to experience volatility in the future in response to quarter-to-quarter variations in: operating results; changes in backlog and new business results; the issuance of analysts reports; market conditions in the industry; prospects of health care reform; changes in governmental regulations; and changes in general conditions in the economy or the financial markets.

The general equity markets have also experienced significant fluctuations in value. This volatility and the market variability has affected the market prices of securities issued by many companies, often for reasons unrelated to their operating performance, and may adversely affect the price of our common stock.

We have never declared a cash dividend on our common stock and do not anticipate paying cash dividends in the foreseeable future. Instead, we intend to retain future earnings for reinvestment in our business.

Failure to satisfy NASDAQ SmallCap Market maintenance criteria could negatively impact the liquidity and market price of our common stock.

Our common stock began trading on the NASDAQ SmallCap Market in December 1997. There are several requirements for continued listing on the NASDAQ SmallCap Market including, but not limited to, a minimum stock price of $1.00 per share and either (a) $2.5 million or more in stockholders equity, (b) market capitalization of $35.0 million or more, or (c) net income in the last fiscal year, or two of the last three fiscal years, of $500,000 or more.

If our common stock price closes below $1.00 per share for 30 consecutive days, we may receive notification from NASDAQ that our common stock will be delisted from the NASDAQ SmallCap Market unless the stock closes at or above $1.00 per share for at least ten consecutive days during the 180-day period following such notification. In the future, our common stock

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price or tangible net worth may fall below the NASDAQ SmallCap Market listing requirements, or we may not comply with other listing requirements, with the result being that our common stock might be delisted. If our common stock is delisted, we may list our common stock for trading over-the-counter. Delisting from the NASDAQ SmallCap Market could adversely affect the liquidity and price of our common stock and it could have a long-term impact on our ability to raise future capital through a sale of our common stock. In addition, it could make it more difficult for investors to obtain quotations or trade our stock.

Our common stock may not continue to qualify for exemption from the penny stock restrictions, which may make it more difficult for you to sell your shares.

The SEC has adopted regulations which define a penny stock to be any equity security that has a market price of less than $5.00 per share, or with an exercise price of less than $5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, these rules require delivery, prior to any transaction in a penny stock, of a disclosure schedule relating to the penny stock market. Disclosure is also required to be made about current quotations for the securities and about commissions payable to both the broker-dealer and the registered representative. Finally, broker-dealers must send monthly statements to purchasers of penny stocks disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. These penny stock restrictions will not apply to our shares of common stock as long as: (1) they continue to be listed on the NASDAQ SmallCap Market; (2) certain price and volume information is publicly available about our shares on a current and continuing basis; and (3) we meet certain minimum net tangible assets or average revenue criteria. Our common stock may not continue to qualify for an exemption from the penny stock restrictions. If our shares of common stock were subject to the rules on penny stocks, the liquidity of our common stock would be adversely affected.

ITEM 2. ***PROPERTIES***

As of December 31, 2005, we leased approximately 34,026 square feet of administrative and corporate offices from an independent landlord in Wayne, Pennsylvania, under a lease expiring in December 2009. The rent in 2005 including the payment of operating expenses such as utilities and maintenance was approximately $89,000 per month.

We lease approximately 1,100 square feet of office space from an independent landlord for our international operations in London, England. The Lease is for a three year period commencing in December 2005 for an annual rent of £26,500 (or approximately $45,600 per year based on an exchange rate of 1.72 USD per 1.00 GBP). The lease will expire in December 2008 and contains certain break points, which allows us to terminate the lease prior to December 2008 without penalty.

ITEM 3. ***LEGAL PROCEEDINGS***

The Company was not involved in any litigation as of December 31, 2005.

ITEM 4. ***SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

No matters were submitted to a vote of security holders in the fourth quarter of 2005.

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PART II

ITEM 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES***

Our common stock is quoted in the NASDAQ Small Cap Market under the symbol CVGR. The following table indicates the high and low bid sale prices per share for each quarter over the last two fiscal years.

	2005		2004	
Quarter Ended	**High Bid**	**Low Bid**	**High Bid**	**Low Bid**
March 31	$2.37	$2.12	$4.15	$2.49
June 30	2.42	2.25	4.31	3.06
September 30	2.60	2.45	4.19	2.20
December 31	2.20	1.99	3.09	2.05

As of March 1, 2006, there were approximately 617 holders of record of our common stock, however, we believe that there are approximately 3,200 additional shareholders in street name who beneficially own our common stock in various brokerage accounts.

We have never declared a cash dividend on our common stock and do not anticipate paying cash dividends in the foreseeable future.

For information concerning our Equity Compensation Plans, see Item 12. Security Ownership of Certain Beneficial Owners and Management.

On July 31, 2003, Dr. Borow, our President and Chief Executive Officer, exercised an employee stock option to acquire 500,000 shares of our common stock. The option had a grant date of August 6, 1998, an expiration date of August 5, 2003 and an exercise price of $0.6875. As payment for the shares issued and related withholding taxes, we received from Dr. Borow 140,432 Covalent common shares that were owned by him. The shares received are included as treasury stock in our Consolidated Balance Sheet at December 31, 2005 and 2004.

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ITEM 6. ***SELECTED FINANCIAL DATA***

The following table represents selected historical consolidated financial data. The statement of operations data for the years ended December 31, 2005, 2004 and 2003 and balance sheet data at December 31, 2004 and 2005 are derived from our audited consolidated financial statements included elsewhere in this report. The statement of operations data for the years ended December 31, 2002 and 2001 and the balance sheet data at December 31, 2003, 2002, and 2001, are derived from audited consolidated financial statements not included in this report. The historical results are not necessarily indicative of the operating results to be expected in the future. The selected data should be read together with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes to the financial statements.

	2005	2004	2003	2002	2001
	(in thousands, except per share data)				
Net revenue [1]	$ 10,403	$ 13,590	$ 20,836	$ 24,677	$ 18,353
Operating expenses [1]	12,028	19,061	21,946	20,607	14,804
Income (Loss) from operations	(1,625)	(5,471)	(1,110)	4,070	3,549
Other income (expense)	140	3	4	(11)	(56)
Income (Loss) before income taxes	(1,484)	(5,468)	(1,106)	4,060	3,493
Income tax provision (benefit)		(1,245)	(544)	1,605	1,458
Net income (loss)	$ (1,484)	$ (4,223)	$ (562)	$ 2,454	$ 2,035
Net income (loss) per common share:					
Basic	$ (0.11)	$ (0.32)	$ (0.04)	$ 0.19	$ 0.16
Diluted	$ (0.11)	$ (0.32)	$ (0.04)	$ 0.19	$ 0.16
Weighted average common and common equivalent shares outstanding					
Basic	13,347	13,239	12,747	12,591	12,420
Diluted	13,347	13,239	12,747	13,199	12,963
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 7,104	$ 3,166	$ 2,070	$ 2,121	$ 3,455
Working capital [2]	5,896	7,111	10,511	10,772	7,898
Total assets	9,843	12,823	20,385	20,836	15,113
Long term debt	37	63	87	3	62
Total liabilities	3,530	5,014	9,043	9,108	6,223
Shareholders equity	6,313	7,809	11,342	11,728	8,889

(1) Excludes the impact of reimbursement for out-of-pocket expenses.

(2) Working capital is calculated as current assets minus current liabilities.

ITEM 7. ***MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

Overview

We are a clinical research organization which is a leader in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. Our mission is to provide our clients with high quality, full-service support for their clinical trials. We offer therapeutic expertise, experienced team management and advanced technologies. Our headquarters is in Wayne, Pennsylvania and our International operations are based in London, England.

The following discussion should be read in conjunction with the Company s consolidated financial statements and notes thereto.

Net revenue is derived principally from the design, management and monitoring of clinical research studies. Clinical research service contracts generally have terms ranging from several months to several years. A portion of the contract fee is generally payable upon execution of the contract, with the balance payable in installments over the life of the contract. Several of our older contracts contain payment schedules that are weighted towards the later stages of the contract. The majority of our net revenue is recognized from fixed-price contracts on a proportional performance basis. To measure the performance, we compare actual direct costs incurred to estimated total contract direct costs, which we believe is the best indicator of the performance of the contract obligations as the costs relate to the labor hours incurred to perform the service.

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Contracts generally may be terminated by clients immediately or with short notice. Clinical trials may be terminated or delayed for several reasons including, among others, unexpected results or adverse patient reactions to the drug, inadequate patient enrollment or investigator recruitment, manufacturing problems resulting in shortages of the drug, client budget constraints or decisions by the client to de-emphasize or terminate a particular trial or development efforts on a particular drug. Depending on the size of the trial in question, a client s decision to terminate or delay a trial in which we participate could have a material and adverse effect on our backlog, future revenue and results from operations.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. On an ongoing basis, management evaluates its judgments and estimates. Management bases its judgments and estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Management considers the following policies to be most critical in understanding the more complex judgments that are involved in preparing our consolidated financial statements and the uncertainties that could affect our results of operations and financial condition.

Revenue Recognition

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

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

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

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

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

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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. In connection with the required implementation on January 1, 2002, of Financial Accounting Standards Board 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 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 exclude from revenue and expense in the Consolidated Statement of Operations fees paid to investigators and the associated reimbursement since we act as agent on behalf of our clients with regard to investigators. 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 $1.2 million, $5.1 million, and $10.5 million for the years ended December 31, 2005, 2004, and 2003 respectively.

Concentration of Credit Risk

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a small number of companies within the pharmaceutical, biotechnology and medical device industries. The significant majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of December 31, 2005, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $1.5 million. Of this amount, the exposure to our three largest clients was 84% of the total, with the three largest clients representing 42%, 29%, and 13% of total exposure, respectively. As of December 31, 2004, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $6.9 million. Of this amount, the exposure to our three largest clients was 55% of the total, with the three largest clients representing 34%, 11%, and 10% of total exposure, respectively.

Operating Expenses

Direct expenses include amounts incurred during the period that are directly related to the management or completion of a clinical trial or related project and generally include direct labor and related benefit charges, other direct costs and certain allocated expenses. Direct costs as a percentage of net revenues tend to fluctuate from one period to another as a result of changes in the mix of services provided and the various studies conducted during any time period. Selling, general and administrative expenses include the salaries, wages and benefits of all administrative, finance and business development personnel, and all other support expenses not directly related to specific contracts.

Stock-Based Compensation

The company has adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants. We account for grants of options to employees and directors under these plans applying the intrinsic value method provided for in Accounting Principles Board (APB) Opinion No. 25 Accounting for Stock Issued to

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Employees and related interpretations. No stock-based compensation expense is reflected in net income as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. In addition to APB Opinion No. 25, we provide the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 123 Accounting for Stock-Based Compensation and by SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure.

Tax Valuation Allowance

The Company estimates its tax liability based on current tax laws in the statutory jurisdictions in which it operates. Because the Company conducts business on a global basis, its effective tax rate has and will continue to depend upon the geographic distribution of its pre-tax earnings (losses) among jurisdictions with varying tax rates. These estimates include judgments about deferred tax assets and liabilities resulting from temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. The Company has assessed the realization of deferred tax assets and a valuation allowance has been established against excess net operating losses based on an assessment that it is more likely than not that realization cannot be assured. The ultimate realization of this tax benefit is dependent upon the generation of sufficient operating income in the respective tax jurisdictions.

Results of Operations

The following table sets forth amounts for certain items in our consolidated statements of operations expressed as a percentage of net revenue. The following table excludes revenue and costs related to reimbursable out-of-pocket expenses because they are not generated by the services we provide, do not yield any gross profit to us, and do not have any impact on our net income. We believe this information is useful to our investors because it presents the net revenue and expenses that are directly attributable to the services we provide to our clients and provides a more accurate picture of our operating results and margins.

Percentage of Net Revenue, Excluding Reimbursable Out-of-Pocket Expenses

	Year Ended December 31,		
	2005	**2004**	**2003**
Net revenue	100.0%	100.0%	100.0%
Operating Expenses			
Direct	71.5%	98.3%	74.0%
Selling, general and administrative	39.2%	36.4%	27.1%
Depreciation	4.9%	5.6%	4.2%
Loss from Operations	(15.6)%	(40.3)%	(5.3)%
Net Loss	(15.6)%	(31.1)%	(2.7)%

Year Ended December 31, 2005 Compared With Year Ended December 31, 2004

Net revenue for 2005 decreased $3.2 million to $10.4 million as compared to $13.6 million for 2004 a decline of 24%. The decline in net revenues for 2005 was due to the completion of several major clinical studies that were in process at the beginning of 2005, combined with delays in starting new clinical studies that were signed in the second half of 2005. Approximately 61% of net revenue for 2005 was attributable to completed studies that were in process at the beginning of 2005. The Company experienced delays in starting several new studies signed in the second half of 2005, due primarily to unforeseen regulatory issues. We were awarded several new business contracts late in the fourth quarter of 2005 which are not expected to generate any significant revenues until 2006. Our backlog at the end of 2005 increased significantly as a result of these new business signings. At the end of 2005, backlog increased by $7.7 million to $22.7 million compared to $15 million at the end of 2004.

In 2004, net revenue was adversely affected by cost increases approximating $1.4 million or 8.8 % in the cost to complete for two legacy projects that were winding down as they entered the final stage of their development schedules. These legacy projects experienced significant increases in their costs to complete without a corresponding increase in revenue in 2004 resulting in lower gross margins and reduced profitability on these projects. The changes in cost estimates and related revenue adjustments for these legacy projects had a material impact on our net income for 2004. In 2005, there was no material impact on net revenue related to the completion of these legacy projects

We may experience similar annual cost increases in the future in our ongoing clinical projects without a corresponding increase in revenues. To the extent the actual estimated cost to complete utilized at the end of 2005 were higher by 5% and 10%, respectively, than the estimates actually utilized, the Company s 2005 reported revenues would have been reduced by

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$92 thousand and $183 thousand, respectively. The Company s consolidated net loss for 2005 would have increased by the same amount as the decline in revenues. This assumes that the Company would have been unsuccessful in negotiating change orders during 2005 that would provide for reimbursement of the excess costs. For periods beyond 2005, the impact on the Company s net income and financial position would depend upon the actual costs incurred to complete the project and whether the Company was successful in negotiating change orders for reimbursement of the excess costs. See Footnote No. 2, Revenue Recognition, for the Company s revenue recognition accounting policies.

Reimbursement revenue consisted of reimbursable out-of-pocket expenses incurred on behalf of our clients. Reimbursements are made at cost, without mark-up or profit, and therefore have no impact on net income.

Direct expenses included compensation and other expenses directly related to conducting clinical studies. These costs decreased by $5.9 million to $7.4 million for the year ended December 31, 2005 from $13.4 million for the year ended December 31, 2004. The decrease in direct expenses resulted principally from a reduction in the level of clinical trial studies conducted by the Company during 2005. Direct expenses as a percentage of net revenue were 72% for the year ended December 31, 2005 as compared to 98% for the year ended December 31, 2004. The improvement was principally due to a significant decrease in the existing base of fixed direct expenses due to headcount reductions as well as reductions in the use of outside independent contractors.

Selling, general, and administrative expenses included the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. Selling, general and administrative expenses for the year ended December 31, 2005 were $4.1 million, or 39% of net revenue, as compared to $4.9 million, or 36% of net revenue, for the year ended December 31, 2004. The decrease of $866 thousand primarily reflected a reduction in administrative staffing levels and the utilization of outside contractors. The increase as a percentage of net revenue generally reflects the significant decrease in net revenues in 2005 compared with 2004 which was greater than the percentage reduction in selling, general and administrative expenses.

Depreciation and amortization expense decreased to $510 thousand for the year ended December 31, 2005 from $759 thousand for the year ended December 31, 2004, primarily as a result of a reduction in fixed asset additions during 2005 compared with 2004.

We realized the full year impact in 2005 from the workforce rationalization and efficiency program implemented in 2004. On August 30, 2004, the Company announced that it had initiated a workforce rationalization and efficiency program to reduce its workforce and cost of operations. The program was completed in the third quarter of 2004 for a one time cost of approximately $151 thousand which we charged in the third quarter of 2004. The annualized cost reduction benefit of the restructuring is approximately $1.1 million.

Loss from operations decreased by $3.8 million to $1.5 million, primarily for the reasons noted in the preceding paragraphs.

Net interest income for the year ended December 31, 2005 was $140 thousand compared to net interest income of $3 thousand for the year ended December 31, 2004. This increase resulted from us having more cash on hand combined with a higher rate of interest earned on invested cash deposits.

The effective income tax rate (benefit) for the year ended December 31, 2005 and 2004 was 0% and (22.8)%, respectively. The Company s effective tax rate in 2004 was negatively affected by the increased loss from operations and a valuation allowance against excess net operating losses that the Company was unable to carryback against prior years. The Company recorded a valuation allowance of $1,068,400 for certain net income tax operating loss carryforwards.

The net loss for the year ended December 31, 2005 decreased to $(1.5) million, or $(.11) per diluted share, as compared to $(4.2) million, or $(.32) per diluted share for the year ended December 31, 2004, primarily for the reasons noted above.

Year Ended December 31, 2004 Compared With Year Ended December 31, 2003

Net revenue for 2004 decreased $7.2 million to $13.6 million as compared to $20.8 million for 2003 a decline of 35%. The decline in net revenues was due to an overall slowdown in new business signings especially in the second half of the year and delays in starting new projects that were signed in the first half of the year. Net revenue was also adversely affected by cost increases approximating $1.4 million or 8.8 % in the cost to complete for two legacy projects that were winding down as they entered the final stage of their development schedules. These legacy projects experienced significant increases in their costs to complete without a corresponding increase in revenue in 2004 resulting in lower gross margins and reduced profitability on these projects. The changes in cost estimates and related revenue adjustments for these legacy projects had a material impact on our net income for 2004.

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We may experience similar annual cost increases in the future in our ongoing clinical projects without a corresponding increase in revenues. To the extent the actual estimated cost to complete utilized at the end of 2004 were higher by 5% and 10%, respectively, than the estimates actually utilized, the Company s 2004 reported revenues would have been reduced by $157 thousand $303 thousand, respectively. The Company s consolidated net loss for 2004 would have increased by the same amount as the decline in revenues. This assumes that the Company would have been unsuccessful in negotiating change orders during 2004 that would provide for reimbursement of the excess costs. For periods beyond 2004, the impact on the Company s net income and financial position would depend upon the actual costs incurred to complete the project and whether the Company was successful in negotiating change orders for reimbursement of the excess costs. See Footnote No. 2, Revenue Recognition, for the Company s revenue recognition accounting policies.

Reimbursement revenue consisted of reimbursable out-of-pocket expenses incurred on behalf of our clients. Reimbursements are made at cost, without mark-up or profit, and therefore have no impact on net income.

Direct expenses included compensation and other expenses directly related to conducting clinical studies. These costs decreased by $2.0 million to $13.4 million for the year ended December 31, 2004 from $15.4 million for the year ended December 31, 2003. The decrease in direct expenses resulted principally from a reduction in the level of clinical trial studies conducted by the Company during 2004. Direct expenses as a percentage of net revenue were 98% for the year ended December 31, 2004 as compared to 74% for the year ended December 31, 2003. The increase in the ratio was principally due to the lower level of net revenue reported during 2004 against an existing base of fixed direct expenses.

Selling, general, and administrative expenses included the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. Selling, general and administrative expenses for the year ended December 31, 2004 were $4.9 million, or 36% of net revenue, as compared to $5.7 million, or 27% of net revenue, for the year ended December 31, 2003. The decrease of $708 thousand primarily reflected a reduction in staffing levels. The increase as a percentage of net revenue generally reflects the impact of increased rent expense against a lower level of net revenue.

Depreciation and amortization expense decreased to $759 thousand for the year ended December 31, 2004 from $878 thousand for the year ended December 31, 2003, primarily as a result of a reduction in fixed asset additions during 2004.

On August 30, 2004, the Company announced that it had initiated a workforce rationalization and efficiency program to reduce its workforce and cost of operations. The program was completed in the third quarter for a one time cost of approximately $151 thousand which was incurred in the third quarter. The annualized benefit of the restructuring is approximately $1.1 million.

Loss from operations increased by $4.4 million to $5.5 million, primarily for the reasons noted in the preceding paragraphs.

Net interest income for the year ended December 31, 2004 was $3 thousand compared to net interest income of $4 thousand for the year ended December 31, 2003, largely the result of having more cash to invest.

The effective income tax rate (benefit) for the year ended December 31, 2004 and 2003 was (22.8)% and (49.2)%, respectively. The Company s effective tax rate in 2004 was negatively affected by the establishment of a valuation allowance against excess net operating losses that the Company was unable to carryback against prior years. The Company recorded a valuation allowance of $704,357 for certain net income tax operating loss carryforwards.

The net loss for the year ended December 31, 2004 increased to $(4.2) million, or $(.32) per diluted share, as compared to $(562) thousand, or $(.04) per diluted share for the year ended December 31, 2003, primarily for the reasons noted above.

Liquidity and Capital Resources

Our primary cash needs are for the payment of salaries and fringe benefits, hiring and recruiting expenses, business development costs, acquisition-related costs, capital expenditures, and facilities related expenses. Our principal source of cash is from contracts with clients. If we are unable to generate new contracts with existing and new clients and/or if the level of contract cancellations increases, revenues and cash flow will be adversely affected. Absent a material adverse change in the level of the Company s new business bookings or contract cancellations, we believe that our existing capital resources together with cash flow from operations will be sufficient to meet our foreseeable cash needs for the next twelve months. However, if we significantly expand our business through acquisitions and/or continue to incur a loss from operations we may need to raise additional funds through the sale of debt or equity securities in order to keep operating our business.

Our contracts usually require a portion of the contract amount to be paid at the time the contract is initiated. Additional payments are generally made upon completion of negotiated performance milestones, or on a regularly scheduled basis, throughout the life of the contract. Several of

our older contracts contain payment schedules that are weighted towards the

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later stages of the contract. Accordingly, cash receipts do not necessarily correspond to costs incurred and revenue recognized. For terminated studies, our contracts frequently entitle us to receive the costs of winding down the terminated project, as well as all fees earned by us up to the time of termination.

Net revenue is recognized on a proportional performance basis. We typically receive a low volume of large-dollar receipts. As a result, the number of days net revenue outstanding in accounts receivable, costs and estimated earnings in excess of related billings, customer advances, and billings in excess of related costs will fluctuate due to the timing and size of billings and cash receipts. At December 31, 2005, the net days revenue outstanding was 49 days compared to 192 days at December 31, 2004. Compared to December 31, 2004, accounts receivable decreased $4.1 million to $1.1 million at December 31, 2005, primarily due to the timing of billings and progress payments for clinical trials. Of the accounts receivable balance at December 31, 2005, less than 1% of the total was over 60 days past the due date.

Compared to December 31, 2004, costs and estimated earnings in excess of related billings on uncompleted contracts decreased $1.3 million to $384 thousand at December 31, 2005. The decrease primarily represents the achievement of certain billing milestones or payment schedules contained in the contracts with our clients. The balance at December 31, 2005 primarily consisted of three clinical trials, which individually constituted 42%, 29% and 13% of the balance. These amounts are expected to be billed during 2006 as billing schedules are met. The decrease in the liability account billings in excess of related costs and estimated earnings on uncompleted contracts of $425 thousand to $1.3 million as of December 31, 2005 from $1.8 million as of December 31, 2004, resulted from the completion of several key projects during the year and the billing of all project related revenue. The $60 thousand decrease in customer advances to $1.0 million as of December 31, 2005 from $1.1 million as of December 31, 2004 resulted primarily from the net utilization of customer advances for investigator payments.

Our net cash provided by operating activities was $4.1 million for the year ended December 31, 2005, compared with net cash provided by operating activities of $704 thousand for the year ended December 31, 2004. The primary factors underlying this change was the decrease in our costs and estimated earnings in excess of related billings on uncompleted contracts relative to the end of the prior year and a significant increase in cash collections of receivables, including the collection of approximately $1.1 million in federal and state income tax refunds. Net cash used by investing activities, consisting principally of purchases of property, equipment and leasehold improvements, was $86 thousand for the year ended December 31, 2005, compared with $275 thousand for the year ended December 31, 2004. Purchases of property and equipment for the year ended December 31, 2005 included leasehold improvements, software and hardware, including host servers and computers for our corporate office and field-based personnel. Net cash used by financing activities was $13 thousand for the year ended December 31, 2005, compared with net cash provided by financing activities of $621 thousand for the year ended December 31, 2004. The primary difference related to reduced proceeds from the exercise of stock options. As a result of these cash flows, our cash and cash equivalents balance at December 31, 2005 was $7.1 million as compared to $3.2 million at December 31, 2004, an increase of $3.9 million.

We previously maintained a demand line of credit with a bank under which maximum borrowings were the lesser of $2.5 million or 75% of eligible accounts receivable, as defined in the loan agreement, and interest was charged at the LIBOR Market Index Rate plus 2.65%. This line of credit expired on August 15, 2004.

The Company has incurred losses in recent years. However, we believe we will be able to return to being a profitable business as a result of anticipated new business awards combined with a leaner cost structure, increased backlog and a more favorable mix of existing contracts. Management believes that cash on hand and cash from operations will be sufficient to meet the Company s obligations for the foreseeable future. In the event that we are not able to develop new business or existing contracts are terminated, there is a potential risk that the Company will not achieve profitability and, accordingly, might not be able to meet future cash obligations. There can be no assurance that anticipated new business will be obtained and if such business is not obtained our financial results and cash flow could be adversely and materially affected.

Off Balance Sheet Financing Arrangements

As of December 31, 2005, we did not have any off-balance sheet financing arrangements or any equity ownership interests in any variable interest entity or other minority owned ventures.

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Contractual Obligations and Commitments

For 2005 and 2004, we entered into no new capital lease obligations as compared to $123 in new capital lease obligations in 2003. These leases were recorded as assets and in general were for peripheral office equipment. We are committed under a number of non-cancelable operating leases, primarily related to office space and other office equipment.

Below is a summary of our future payment commitments by year under contractual obligations as of December 31, 2005. Actual amounts paid under these agreements could be higher or lower than the amounts shown below as a result of changes in volume and other variables:

	Total	1 Year	2-3 Years	4-5 Years	>5 Years
Obligations under capital leases	$ 63,309	$ 26,314	$ 36,995	$	$
Operating leases	3,917,549	966,619	1,981,189	969,741	
Employment agreement	86,000	86,000			
Service agreements	934,286	338,077	449,285	146,924	
Total	$ 5,001,144	$ 1,417,010	$ 2,467,469	$ 1,116,665	$

In 2006, we anticipate capital expenditures of approximately $150,000 $250,000 for leasehold improvements, software applications, workstations, personal computer equipment and related assets. A significant portion of our service agreement commitments, which are primarily comprised of investigator payments, are expected to be reimbursed under agreements with clients.

Recently Issued Accounting Standards

In January 2003, the FASB issued Financial Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities an Interpretation of ARB No. 51. FIN 46 addresses consolidation by business enterprises of variable interest entities. In December 2003, the FASB then issued FIN 46(R), Consolidation of Variable Interest Entities an Interpretation of ARB No. 51, which replaced FIN 46. Application of FIN 46(R) was required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public entities for all other types of entities are required in financial statements for periods ending after March 15, 2004. The Company had adopted both FIN 46 and FIN 46(R), and the adoption had no impact on the Company s financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. The provisions of SFAS No. 149 that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. The Company has not entered into any derivative transactions and therefore the adoption of this standard has not had a material impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity , which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope, which may have previously been reported as equity, as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of SFAS No. 150 has not had a material impact on our financial statements. .

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment SFAS No. 123(R) revises SFAS 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees , and its related implementation guidance. SFAS 123(R) will require compensation costs related to share-based payment transactions to be recognized in the financial statements. The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. This statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company is currently evaluating the impact from this standard on its future results of operations and financial position.

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ITEM 7A. ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***
Market Risk

The fair values of cash and cash equivalents, restricted cash, accounts receivable, costs and estimated earnings in excess of related billings on uncompleted contracts, accounts payable, accrued expenses and billings in excess of related costs and estimated earnings on uncompleted contracts were not materially different than their carrying amounts as reported at December 31, 2005 and December 31, 2004.

As of December 31, 2005, the Company was not a counterparty to any forward foreign exchange contracts or any other transaction involving a derivative financial instrument.

Foreign Currency Exchange Risk

The Company is exposed to foreign currency exchange risk through its international operations. For the year ended December 31, 2005, approximately 7% of our net revenue was derived from contracts denominated in other than U.S. Dollars. Our financial statements are denominated in U.S. Dollars. As a result, factors associated with international operations, including changes in foreign currency exchange rates, could affect our results of operations and financial condition. Contracts entered into in the U.S. are denominated in U.S. Dollars. Contracts entered into by our international subsidiary are generally denominated in pounds sterling or Euros. To date, we have not engaged in any derivative or contractual hedging activities related to our foreign exchange exposures. We believe that these exposures are limited by virtue of their size relative to our overall operations as well as the partial natural hedge afforded by our local currency expenditures to service these local currency contracts.

Assets and liabilities of the Company s international operations are translated into U.S. Dollars at exchange rates in effect on the balance sheet date and equity accounts are translated at historical exchange rates. Revenue and expense items are translated at average exchange rates in effect during the quarter. Gains or losses from translating foreign currency financial statements are recorded in other comprehensive income. The cumulative translation adjustment included in other comprehensive income for the years ended December 31, 2005, December 31, 2004 and December 31, 2003 was ($23) thousand, $45 thousand, and $99 thousand, respectively.

We believe that the effects of inflation generally have not had a material adverse impact on our operations or financial condition.

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***
Our financial statements listed below are contained herein beginning at page F-1:

(a) Financial Statements

ITEM 9. ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***
Not applicable.

ITEM 9A. ***CONTROLS AND PROCEDURES***
The Company s principal executive officer and principal financial officer, with the participation of other members of the Company s management, have evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities and

Exchange Act of 1934, as amended) as of the end of the period covered by this report (the Evaluation Date) and, based on that evaluation, concluded that, as of the Evaluation Date, the Company s disclosure controls and procedures were effective to ensure that information that is required to be disclosed in its reports under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management,

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including the Company s principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure,

Our management, including our principal executive and principal financial officers, has evaluated any changes in our internal control over financial reporting that occurred during the year ended December 31, 2005, and has concluded that there was no change that occurred during the quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART III

ITEM 10. ***DIRECTORS AND EXECUTIVE OFFICERS OF REGISTRANT***

Directors

Name	Age	Director Since	Principal Occupation
Kenneth M. Borow, M.D.	58	1998	President and Chief Executive Officer of the Company
Earl M. Collier, Jr.	58	2002	Executive Vice President, Genzyme Corporation
Scott M. Jenkins	51	2001	President of S.M. Jenkins & Co., General Partner, Jenkins Partners, L.P.
Christopher F. Meshginpoosh	37	2005	Director, Kreischer Miller

Kenneth M. Borow, M.D. has been President and Chief Executive Officer and a Director since 2000 and joined the Company in 1997 as Vice President of Operations and Chief Medical Officer. For the previous four years, Dr. Borow was Senior Director, Medical Research Associates Department, Merck Research Laboratories, where he directed clinical research operations for 163 different protocols, and developed a Merck-based contract group consisting of field monitors, data coordinators and statisticians. Previously, he was a Professor of Medicine and Pediatrics at the University of Chicago, and originator of a worldwide clinical research program in cardiac function which included investigative sites in the United States, United Kingdom, Norway, Israel and South Africa. Dr. Borow graduated from the Temple Medical School in 1974. Dr. Borow is a Harvard-trained Internist, Pediatrician, Adult Cardiologist and Pediatric Cardiologist.

Earl M. Collier, Jr. has been a Director since March 2002. Mr. Collier is currently Executive Vice President, Genzyme Corporation. Prior to joining Genzyme in 1997, Mr. Collier was President of Vitas Healthcare Corporation, the largest provider of hospice services in the United States. Previously, Mr. Collier was a partner with the Washington, D.C. based law firm of Hogan and Hartson. He also served as Deputy Administrator for the Health Care Financing Administration during the Carter Administration. Mr. Collier earned a B.A. at Yale University and a J.D. at the University of Virginia Law School.

Scott M. Jenkins has been a Director since October 2001. He is currently President of S. M. Jenkins & Co., which he founded in 1991. S. M. Jenkins & Co. provides a wide range of financial and consulting services to private companies, wealthy family groups and a variety of businesses. In addition, Mr. Jenkins is the General Partner of Jenkins Partners, L.P., which has invested in many early stage, private and public companies. Prior to founding S. M. Jenkins & Co., Mr. Jenkins was with Goldman Sachs & Co., where he worked from 1984 until 1990 when he joined First Boston Corporation. Mr. Jenkins has also served in the not-for-profit healthcare sector as the Chair of the Board of Trustees of the Presbyterian Medical Center of Philadelphia Foundation, which is now part of the University of Pennsylvania Health System.

Christopher F. Meshginpoosh has been a director since April 2005. He is currently Director of Consulting Services for Kreischer Miller, one of the Philadelphia area s largest accounting and advisory firms. Prior to joining Kreischer Miller, he was Chief Financial Officer and Secretary of Liquent, Inc. from 2000 to 2002. He also was a consultant and subsequently the Vice President of Finance at Luminant Worldwide Corporation, which filed for Chapter 11 bankruptcy protection in December 2001, from December 1999 to September 2000. Mr. Meshginpoosh is a certified public accountant and holds a B.S., Accounting from West Chester University.

Executive Officers

Executive officers serve at the discretion of the Board and serve until their successors have been duly elected and qualified or until their earlier resignation or removal. The executive officers of the Company as of March 1, 2006 were:

Name	Age	Position(s) Held With Company
Kenneth M. Borow, M.D.	58	President, Chief Executive Officer, Director
Lawrence R. Hoffman	51	Executive Vice President, General Counsel, Secretary and Chief Financial Officer
Alison O Neill	41	Senior Vice President, Clinical Operations

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Kenneth M. Borow, M.D. has been President and Chief Executive Officer of the Company since January 2000. Dr. Borow s biographical information appears above under the caption Directors .

Lawrence R. Hoffman joined the Company in July 2004 as Executive Vice President and Chief Financial Officer. In February 2005, he was promoted to Executive Vice President, General Counsel, Secretary and Chief Financial Officer. From January 2003 to July 2004, Mr. Hoffman was an independent financial consultant. From July 2000 to January 2003, he was Vice President and Chief Financial Officer of Cytogen Corporation a publicly traded biopharmaceutical company. From April 1998 to July 2000, Mr. Hoffman was Vice President and Chief Financial Officer of the Liposome Company, a publicly traded biopharmaceutical company which was sold to Elan PLC in May 2000.

Mr. Hoffman is a certified public accountant and attorney with a J.D. from Temple University School of Law, and an LLM (Taxation) from Villanova University School of Law. He received his B.S. with a major in accounting from LaSalle University.

Alison O Neill has been Senior Vice President, Clinical Operations since January 1, 2004. Mrs. O Neill previously served as Vice President of Global Project Management from April 2001 until December 31, 2003. From 1996 to April 2001, Mrs. O Neill was employed with Ingenix Pharmaceutical Services (successor to ClinPharm Ltd.), culminating as Senior Director, Clinical Operations. Mrs. O Neill has 22 years of experience in the pharmaceutical industry both in pharma companies and contract research organizations and has worked across therapeutic areas and phases of development.

Director Independence

The Board of Directors has determined that the following directors are independent under the listing standards of the NASD; Mr. Collier, Mr. Jenkins and Mr. Meshginpoosh.

Committees of the Board

The Board has a Compensation and an Audit Committee.

Compensation Committee. The Compensation Committee reviews and approves salaries for corporate officers and reviews, approves and administers the Company s stock option plan grants thereunder. The Compensation Committee met three times during 2005. The Compensation Committee is presently comprised of two non-employee directors, Scott M. Jenkins (Chairman) and Earl M. Collier, Jr.

Audit Committee. The Audit Committee oversees the Company s accounting, financial reporting process, internal controls over financial reporting and audits, and consults with management, and the independent public accountants on, among other items, matters related to the annual audit, published financial statements and accounting principles applied. As part of its duties, the Audit Committee appoints, evaluates and retains the Company s independent registered public accounting firm. It also maintains direct responsibility for the compensation, termination and oversight of the Company s independent registered public accounting firm and evaluates the independent public accountants qualifications, performance and independence. The Audit Committee approves all services provided to the Company by the independent registered public accounting firm. The Audit Committee has established procedures for the receipt, retention and treatment, on a confidential basis, of complaints received by the Company, regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submissions by employees of concerns regarding questionable accounting or auditing matters. In 2005, the Audit Committee was composed of Christopher F. Meshginpoosh (Chairman), Earl M. Collier, Jr., and Scott M. Jenkins. Mr. Meshginpoosh joined the Board of Directors in April 2005 and concurrently was appointed Chairman of the Audit Committee. Prior to the appointment of Mr. Meshginpoosh as Chairman, Mr. Jenkins was acting Chairman of the Audit Committee. Each member of the Audit Committee is independent as defined in the Securities Exchange Act of 1934, as amended, and applicable rules of The Nasdaq Stock Market. The Board of Directors has determined that Mr. Meshginpoosh is an audit committee financial expert as defined in rules of the Securities and Exchange Commission under the Sarbanes-Oxley Act of 2002. The Audit Committee met five times in 2005.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s executive officers and directors to file initial reports of ownership and reports of change of ownership with the SEC. Executive officers and directors are required by SEC

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regulations to furnish the Company with copies of all Section 16(a) forms they file. Based solely upon a review of copies of reports furnished to the Company during the fiscal year ended December 31, 2005, all executive officers and directors were in compliance.

Code of Business Conduct and Ethics

The Board of Directors is committed to ethical business practices. The Company adopted a corporate code of ethics in September 2004. The code of ethics applies to all of the Company s employees and directors and includes the code of ethics for the Company s principal executive officer, principal financial officer, and principal accounting officer within the meaning of the SEC regulations adopted under the Sarbanes-Oxley Act of 2002. The Company s corporate code of ethics is posted under the Investor Relations section of its website at: www.covalentgroup.com. Please note that none of the information on the Company s website is incorporated by reference in this proxy statement.

ITEM 11. ***EXECUTIVE COMPENSATION***

The following table sets forth the total compensation paid by the Company to the Chief Executive Officer and the two other most highly compensated individuals who served as executive officers in 2005 and were paid more than $100,000 in salary and bonus for 2005 (the Named Executive Officers).

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-term Compensation Shares Underlying	All Other
Name and Principal Position	**Year**	**Salary**	**Bonus**	**Options (#)**	**Compensation [1]**
Kenneth M. Borow, M.D.	2005	$ 344,970		500,000	$ 1,993
	2004	$ 331,852			$ 1,656
President and Chief Executive Officer	2003	$ 340,813			$ 1,406
Lawrence R. Hoffman [2]	2005	$ 216,666		100,000	$ 1,100
	2004	$ 78,461		100,000	
Executive Vice President, General Counsel, Secretary and Chief Financial Officer					
Alison O Neill[3]	2005	$ 181,603		75,000	$ 1,215
	2004	$ 198,096		25,000	$ 50,113[4]
Senior Vice President, Global Operations					

(1) Represents Company matching contributions under the Company s employee s savings (401K) plan.
(2) Mr. Hoffman joined the Company in July 2004 as Executive Vice President and Chief Financial Officer.
(3) Ms. O Neill was promoted to Senior Vice President, Global Operations effective January 2, 2004. Effective June 1, 2004, she relocated to the United States from the Company s United Kingdom office. From January through May 2004, she was paid in British pound sterling. The salary payments she received in British pound sterling were converted to USD at a conversion rate of $1.84 USD per 1.00 British pound sterling.
(4) Includes Company contributions to a pension plan, $3,809 in 2004, and payments for a car allowance, $3,680 in 2004. Ms. O Neill s pension plan and car allowance contributions for 2004 are based on a conversion rate of $1.84 USD per 1.00 British pound sterling. Also included is $42,624 of moving expenses in connection with Ms. O Neill s relocation to the United States from the United Kingdom.

Employment Agreement; Termination of Employment and Change-in-Control Arrangement

We entered into an employment agreement with Dr. Borow, as of March 31, 2003. Pursuant to the employment agreement (which replaced a prior agreement), which has a term of three years expiring March 31, 2006, Dr. Borow received an annual base salary of $325,000, subject to increases in each subsequent year tied to increases in the consumer price index. In addition, the Company paid to Dr. Borow the sum of $35,937

in 2003 (which is the difference between the base salary actually paid for the period February 1, 2002 through January 31, 2003 and the base salary he would have been paid had his base salary been equal to $300,000). Pursuant to the employment agreement, Dr. Borow is eligible to receive an annual bonus of up to 50% of his base salary, depending upon the Company s attainment of its operating goals and his individual performance. Up to one-half of Dr. Borow s maximum annual bonus is based on objective tests and up to one-half of his maximum bonus is determined in the sole discretion of the Compensation Committee. Under certain circumstances relating

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to the termination of Dr. Borow s employment, the Company may be obligated to pay Dr. Borow severance compensation for up to one year (at a rate equal to his then base salary) and, in such event, the Company also would be obligated to continue group health coverage for Dr. Borow for a period of one year and, to the extent not already vested, of all of Dr. Borow s stock options would vest. In addition, if a change in control (as defined in the agreement) occurs during the term of Dr. Borow s employment agreement (or within one year thereafter under certain circumstances), the Company would be obligated to pay Dr. Borow a change in control payment in an amount ranging from one to five times his then base salary, depending upon the growth in stockholder value as reflected by the trading price of the Company s common stock (or, under certain circumstances, the amount of the consideration to be received by the stockholders in such transaction). We expect to negotiate a new employment agreement with Dr. Borow in connection with the proposed acquisition of the shares of Remedium OY which is expected to close at the end of the second quarter of 2006. It is expected that Dr. Borow s current contract will expire before a new employment agreement can be executed.

Mr. Hoffman is currently a party to an Executive Severance Agreement with the Company in the event his employment with us is terminated in connection with a change of control as set forth therein. Such agreement provides, generally, for the payment of twelve months base salary, a pro-rata portion of any such bonus compensation due Mr. Hoffman and the continuation of certain company paid fringe benefits for twelve months. We do not have any separate Executive Severance Agreements with any other executive officers.

Option Grant Table

The following table provides information about grants of stock options made during 2005 to each of the Named Executive Officers.

	Individual Grants					
	Number of Shares Underlying Options Granted	Percentage of Total Options Granted to Employees	Exercise Price	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation of Option Term[3] 5%	10%
Kenneth M. Borow, M.D [1]	500,000	65%	$2.25	7/01/2010	$1,391,147	$1,755,456
Lawrence R. Hoffman [1]	100,000	13%	$2.25	7/01/2010	$ 278,229	$ 351,091
Alison O Neill[2]	75,000	10%	$2.25	7/01/2010	$ 208,672	$ 263,318

(1) Each option has a term of five years from the date of grant and vests ratably over a three-year period, beginning on the first anniversary of the date of grant.

(2) Each option has a term of five years from the date of grant with 20% of the grant vesting on the date of grant and the remainder vesting ratably over the next four years.

(3) The amounts shown are hypothetical gains based on the indicated assumed rates of appreciation of Common Stock compounded annually for a five-year period. There can be no assurance that the Common Stock will appreciate in value at any particular rate or at all in future years.

Aggregated Fiscal Year-End Option Values

The following table presents certain information with respect to the exercise of options during 2005 by the Named Executive Officers and the number and value at December 31, 2005, of options held by each of the Named Executive Officers. The value actually realized upon future option exercises by the Named Executive Officers will depend on the value of the Common Stock at the time of exercise.

			Number of Shares Underlying Unexercised Options		Values of Unexercised In-The-Money Options[1]	
Name	Shares Acquired on Exercise (#)	Value Realized ($)	Exercisable	Unexercisable	Exercisable	Unexercisable
Kenneth M. Borow, M.D.			50,000	500,000	$12,125	$

Lawrence R. Hoffman.	33,334	66,666	$	$
Alison O Neill	58,400	89,600	$	$

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(1) Based on the closing price of $2.18 of the Common Stock on the Nasdaq SmallCap Market on December 31, 2005 net of the exercise price.

Directors Compensation

Non-employee directors receive $37,500 per year for their service as directors paid at the rate of $3,125 per month, and are reimbursed for reasonable expenses incurred in connection with attendance at meetings of the Board. Non-employee directors who are Chairman of the Audit and Compensation Committees may receive an annual grant to purchase 25,000 shares of Common Stock. All other non-employee directors may receive an annual grant to purchase 20,000 shares of Common Stock. The option grant vests pursuant to the terms of the Company s stock option plans.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee currently consists of Scott M. Jenkins (Chairman) and Earl M. Collier, Jr. each of whom is a non-employee director. There are no compensation committee interlocks between the Company and any other entity involving the Company s or such other entity s executive officers or board members.

Report of the Compensation Committee of the Board of Directors

The following report was prepared by the Compensation Committee, which was comprised during 2005 of Mr. Jenkins (Chairman) and Mr. Collier. The Compensation Committee is responsible for establishing and overseeing policies governing compensation programs for executive-level officers of the Company in order to attract, motivate and retain key executives responsible for the operations of the Company.

Compensation Policies

The Company s executive compensation policies and specific compensation programs are intended to further the principal objective of maximizing long-term shareholder value. The Compensation Committee believes that this objective, and the long-term interests of shareholders, are best achieved by attracting and retaining high-quality management, and that executive compensation should be determined according to a competitive framework and based on overall financial results and individual contributions to the business consistent with overall corporate needs and objectives. The ultimate purpose of executive compensation policies and programs is to attract and retain high-quality executives and to motivate the entire management team to put forth maximum efforts toward achieving the Company s financial and business objectives. The Compensation Committee believes the executive compensation policies and programs of the Company are consistent with this policy.

Within the overall philosophy, the Compensation Committee has established specific objectives to:

- offer a total compensation program that is competitive and consistent with compensation levels for executive officers holding positions of comparable responsibility in the contract research industry;
- promote achievement of annual financial and business objectives of the Company;
- motivate key executives to fulfill their responsibilities in meeting the business objectives of the Company; and
- reward executives for long-term strategic management and the enhancement of shareholder value.

Compensation Programs

There are three major components of the Company s executive compensation programs:

- base annual salary;

annual cash incentives (or bonuses); and

long-term incentives.

In setting annual base salary levels and annual incentives for executive officers, the Compensation Committee evaluates the responsibilities of the position held and the experience of the individual, as well as consideration of compensation practices and financial performance for comparable positions within the pharmaceutical and biotechnology industries. In addition, the performance of each individual executive officer is considered, as well as the Company s overall financial performance for the previous fiscal year and the contributions to such performance made

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by the executive officer and his or her department. However, the Compensation Committee does not apply any specific formula or assign any specific weights to these factors in making compensation decisions.

Long-term incentive awards consist of options to acquire shares of Common Stock under the Company s equity incentive plans. In 2005, 500,000 common stock options were awarded to Dr. Borow, 100,000 common stock options were granted to Mr. Hoffman; and 75,000 common stock options were awarded to Ms. O Neill. The Compensation Committee believes making these various long-term compensation programs available to executive officers, coupled with annual base salaries and bonuses, further the objectives of the Compensation Committee of aligning the interests of executive officers with the interests of long-term shareholders.

CEO Compensation

We entered into an employment agreement with Dr. Borow, as of March 31, 2003. Pursuant to the employment agreement (which replaced a prior agreement), which will expire on March 31, 2006, Dr. Borow received an annual base salary of $325,000, subject to increases in each subsequent year tied to increases in the consumer price index. In addition, pursuant to the agreement, Dr. Borow is eligible to receive an annual bonus of up to 50% of his base salary, depending upon the Company s attainment of its operating goals and his individual performance. Up to one-half of Dr. Borow s maximum annual bonus is based on objective tests and up to one-half of his maximum bonus is determined in the sole discretion of the Compensation Committee. Under certain circumstances relating to the termination of Dr. Borow s employment, the Company may be obligated to pay Dr. Borow severance compensation for up to one year (at a rate equal to his then base salary) and, in such event, the Company also would be obligated to continue group health coverage for Dr. Borow for a period of one year and, to the extent not already vested, all of Dr. Borow s stock options would vest. In addition, if a change in control (as defined in the agreement) occurs during the term of Dr. Borow s employment agreement (or within one year thereafter under certain circumstances), the Company would be obligated to pay Dr. Borow a change in control payment in an amount ranging from one to five times his then base salary, depending upon the growth in stockholder value as reflected by the trading price of the Company s common stock (or, under certain circumstances, the amount of the consideration to be received by the stockholders in such transaction). We expect to negotiate a new employment agreement with Dr. Borow in connection with the proposed acquisition of the shares of Remedium OY which is expected to close at the end of the second quarter of 2006. It is expected that Dr. Borow s current contract will expire before a new employment agreement can be executed.

In determining the base annual salary, annual cash incentives and the other principal economic terms included in Dr. Borow s employment agreement, the Compensation Committee s goal was to provide total annual compensation intended to compensate Dr. Borow fairly in relation to comparable positions within the contract research industry (while recognizing that most of the other publicly-traded contract research organizations are substantially larger than the Company), as well as to retain the services of Dr. Borow for the Company and continue to motivate him to use his maximum efforts to further the business objectives of the Company. The Compensation Committee specifically noted Dr. Borow s significant contributions to the business development efforts of the Company.

In light of the Company s financial results in 2005 (noting in particular the decrease in net revenues and the significant loss from operations), Dr. Borow did not receive an annual bonus for 2005 based upon the operating performance criteria contained in the employment agreement. Dr. Borow did receive a cost of living adjustment in 2005 of 4.1% pursuant to the terms of his employment agreement. The cost of living adjustment was based on the consumer price index for the Philadelphia area (the region in which the Company is headquartered) as published by the U.S. Department of Labor, Bureau of Labor Statistics.

Submitted by the Compensation Committee of the Board of Directors

SCOTT M. JENKINS, CHAIRMAN

EARL M. COLLIER, JR.

March 15, 2006

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PERFORMANCE GRAPH

The following line graph shows the percentage change in the cumulative total return performance (assuming reinvestment of dividends) to holders of Common Stock with that of the Nasdaq Stock Market (U.S. companies) and a self-constructed peer group index of contract research organizations (comprised of Kendle, International, Icon plc, Parexel, Inc., Pharmaceutical Product Development, Inc., SFBC International, and Covance, Inc.). The comparison includes the period beginning January 1, 2000 through December 31, 2005. Shares of the Company s Common Stock are traded on the Nasdaq SmallCap Market under the symbol CVGR. The comparison of the cumulative return for each investment assumes that $100 was invested in Common Stock and in each index on January 1, 2000.

ITEM 12. ***SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT***

The following table sets forth, as of February 28, 2006, certain information with regard to beneficial ownership of outstanding shares of the Company s Common Stock by (i) each director and Named Executive Officer individually, (ii) all executive officers and directors of the Company as a group, and (iii) each person known by the Company to beneficially own five percent or more of the outstanding shares of the Company s Common Stock:

Name of Beneficial Owner[1][2]	Number of Shares	Percentage of Outstanding Shares
Kenneth M. Borow, M.D.	979,568[3][4]	7.26%
Earl M. Collier, Jr.	72,500[3]	*
Scott M. Jenkins	102,200[3]	*
Christopher F. Meshginpoosh	8,332[3]	*
Lawrence R. Hoffman	33,334[3]	*
Alison O Neill	68,000[3]	*
All executive officers and directors as a group (six persons)	1,263,934[3]	9.40%
Richard D. Propper, M.D. 4350 La Jolla Village Dr., Suite 970 San Diego, CA 92121	821,148[5]	6.08%
Hassan Nemazee 777 Park Avenue New York, NY 10021	1,033,010[6]	7.65%
Houston Ventures, Inc. 720 Fifth Avenue New York, NY 10019	1,000,000[7]	7.41%
Wells Fargo & Company 525 Market Street San Francisco, CA 94105	1,752,290[8]	12.98%

* Less than 1% of the outstanding Common Stock.

(1) Unless otherwise noted, the Company believes that all persons have sole voting and investment power with respect to all shares of Common Stock beneficially owned by them.

(2) Unless otherwise noted, the address of such persons is: c/o Covalent Group, Inc., One Glenhardie Corporate Center, 1275 Drummers Lane, Wayne, PA 19087.

(3) The amounts shown include shares of Common Stock which may be acquired currently or within 60 days of February 28, 2006 through the exercise of stock options, as follows: Dr. Borow 50,000 shares; Mr. Collier 72,500 shares; Mr. Jenkins 82,500 shares; Mr. Meshginpoosh 8,332 shares; Mr. Hoffman 33,334; Mrs. O Neill 68,000 shares; and all current executive officers and directors as a group 1,263,934 shares.

(4) Includes 39,000 shares owned indirectly that are held by certain members of Dr. Borow s immediate family and over which Dr. Borow has sole investment and voting power. Of the shares owned by Dr. Borow, 460,000 shares have been pledged as collateral for a promissory note to Richard D. Propper, M.D. payable in August 2006.

(5) As per the Schedule 13G filed by Richard Propper on February 10, 2005.

(6) As per the Schedule 13D/A filed by Hassan Nemazee on February 4, 2000, includes 500,000 shares of Common Stock owned by Houston Ventures, Inc. as to which Hassan Nemazee has joint power, as well as 33,010 shares held by Mr. Nemazee s children.

(7) As per the Schedule 13D/A field by Houston Ventures, Inc. on February 4, 2000, includes beneficial ownership of 500,000 share of Common Stock otherwise beneficially owned by Hassan Nemazee.

(8) As per the Schedule 13 G filed by Wells Fargo & Company on January 26, 2006.

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The following table details information regarding the Company s existing equity compensation plans as of December 31, 2005:

Equity Compensation Plan Information

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,362,873	2.50	706,026
Equity compensation plans not approved by security holders			
Total	1,362,873	2.50	706,026

ITEM 13. ***CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS***

During 2005, the Company has not engaged in any transactions with its directors or executive officers which are required to be disclosed under this section.

ITEM 14. ***PRINCIPAL ACCOUNTANT FEES AND SERVICES***

Deloitte & Touche LLP served as the Company s independent registered public accounting firm for the fiscal year ended December 31, 2005. During the fiscal years ended December 31, 2005 and 2004, fees in connection with services rendered by Deloitte & Touche LLP were:

Fee Category	Fiscal 2005	Fiscal 2004
Audit Fees	$ 247,500	$ 248,700
Audit-Related Fees	$ 18,900	$ 32,000
Tax Fees	$ 3,200	$ 43,800
All Other Fees	$	$ 7,800
Total	$ 269,600	$ 332,300

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Audit fees consisted of fees for the audit of the Company s annual financial statements and review of quarterly financial statements as well as services normally provided in connection with statutory and regulatory filings or engagements, consents and assistance with and review of the Company s documents filed with the SEC. Audit-related fees consist of the audit of the Company s operations in the UK. Tax fees consisted primarily of fees for tax compliance and tax advice. Except as set forth above, the Company made no other payments to Deloitte & Touche LLP for services rendered during fiscal 2005 and 2004.

Policy for Pre-Approval of Audit and Non-Audit Services

The Audit Committee s Charter includes a formal policy concerning the pre-approval of audit and non-audit services to be provided by the independent accountants to the Company. The policy requires that all services to be performed by Deloitte & Touche LLP, including audit services, audit-related services and permitted non-audit services, be pre-approved by the Audit Committee. The Audit Committee may delegate pre-approval authority to the Chairman of the Audit Committee. All services rendered by Deloitte & Touche LLP are permissible under applicable laws and regulations, and the Audit Committee pre-approved all audit, audit-related and non-audit services performed by Deloitte & Touche LLP during fiscal 2005 and 2004. The Audit Committee considered whether the provision of services other than the audit services (as specified above) was compatible with maintaining Deloitte & Touche LLP s independence and determined that provision of such services has not adversely affected Deloitte & Touche LLP s independence.

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PART IV

ITEM 15. ***EXHIBITS AND FINANCIAL STATEMENT SCHEDULES***

(a) Financial Statement Schedule.
Schedule II- Valuation and Qualifying Accounts. Filed herewith.

(b) Exhibits

2.1	Combination Agreement between Covalent Group, Inc. and the Remedium Stockholders. Filed herewith.
3.1	Certificate of Incorporation of Covalent Group, Inc., a Delaware corporation, filed with the Secretary of State of the State of Delaware on April 16, 2002. (1)
3.2	Bylaws of Covalent Group, Inc., a Delaware corporation. (1)
10.1	Covalent Group, Inc. 2002 Equity Incentive Plan. (2)*
10.2	Amended and Restated Covalent Group, Inc. 1996 Stock Incentive Plan. (3)*
10.3	1995 Stock Option Plan. (4)*
10.4	Lease between Dean Witter Realty Income Partnership II and Covalent Group, Inc. dated November 14, 1996. (4)
10.5	Fourth Amendment to Lease between FV Office Partners, L.P. (successor to Dean Witter Realty Income Partnership II) and Covalent Group, Inc. dated November 27, 2001. (5)
10.6	Fifth Amendment to Lease between FV Office Partners, L.P. and Covalent Group, Inc. dated December 13, 2002. (6)
10.7	Loan Agreement with Wachovia Bank, National Association dated June 17, 2003. (7)
10.8	Employment Agreement between Covalent Group, Inc. and Kenneth M. Borow, M.D. (6)*
10.9	Form of Indemnification Agreement between Covalent Group, Inc., a Delaware Corporation, and its officers and directors. (8)
10.10	Amended and Restated Employment Agreement between Covalent Group, Inc. and Brian Dickson, M.D. (9)*
10.11	Letter Agreement between Covalent Group, Inc. and Lawrence R. Hoffman (10)
10.12	Executive Severance Agreement between Covalent Group Inc. and Lawrence R. Hoffman (11
10.13	Lease Agreement between Ealing Studios and Covalent Group Limited dated March 7, 2006. Filed herewith.
21	Subsidiaries of the Registrant. Filed herewith.
23	Consent of Deloitte & Touche LLP. Filed herewith.
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
31.2	Certification of Principal Accounting Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
32.1	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.
32.2	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.

(1)

Filed as an Exhibit on Form 8-K (No. 0-21145) filed with the Securities & Exchange Commission on July 2, 2002 and incorporated herein by reference.

(2) Incorporated by reference to Appendix E of the Proxy Statement for the 2002 Annual Meeting of Stockholders.

(3) Incorporated by reference to Annex A of the Proxy Statement for the 2000 Annual Meeting of Stockholders.

(4) Filed as an Exhibit to our Annual Report on Form 10-KSB (No. 0-21145) filed with the Securities and Exchange Commission on March 30, 1998 and incorporated herein by reference.

(5) Filed as an Exhibit to our Annual Report on Form 10-KSB (No. 0-21145) filed with the Securities and Exchange Commission on April 1, 2002 and incorporated herein by reference.

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(6) Filed as an Exhibit to our Annual Report on Form 10-KSB (No. 0-21145) filed with the Securities and Exchange Commission on March 31, 2003 and incorporated herein by reference.
(7) Filed as an Exhibit to our Quarterly Report on Form 10-Q (No. 0-21145) filed with the Securities & Exchange Commission on August 13, 2003 and incorporated herein by reference.
(8) Filed as an Exhibit to our Quarterly Report on Form 10-QSB (No. 0-21145) filed with the Securities & Exchange Commission on August 13, 2002 and incorporated herein by reference.
(9) Filed as an Exhibit to our Quarterly Report on Form 10-Q (No. 0-21145) filed with the Securities & Exchange Commission on November 13, 2003 and incorporated herein by reference.
(10) Filed as an Exhibit to or Quarterly Report on Form 10-Q (No. 0-21145) filed with the Securities & Exchange Commission on November 15, 2004 and Incorporated herein by reference.
(11) Filed as an Exhibit on Form 8-K (No. 0-21145) filed with the Securities & Exchange Commission on October 4, 2005 and incorporated herein by reference

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COVALENT GROUP, INC.

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005, 2004 and 2003

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIR M

To the Board of Directors and Stockholders of:

Covalent Group, Inc.

Wayne, Pennsylvania

We have audited the accompanying consolidated balance sheets of Covalent Group, Inc. and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Covalent Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

Philadelphia, Pennsylvania

March 24, 2006

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Covalent Group, Inc.

Consolidated Statements of Operations

	Year Ended December 31,		
	2005	**2004**	**2003**
Net revenue	$ 10,403,079	$ 13,589,614	$ 20,835,742
Reimbursement revenue	2,323,921	5,387,731	5,793,459
Total Revenue	12,727,000	18,977,345	26,629,201
Operating Expenses			
Direct	7,441,145	13,360,367	15,417,144
Reimbursable out-of-pocket expenses	2,323,921	5,387,731	5,793,459
Selling, general and administrative	4,076,696	4,942,316	5,650,693
Depreciation and amortization	510,338	758,779	877,623
Total Operating Expenses	14,352,100	24,449,193	27,738,919
Loss from Operations	(1,625,100)	(5,471,848)	(1,109,718)
Interest income	150,112	13,625	16,545
Interest expense	(9,751)	(10,425)	(12,962)
Net Interest Income	140,361	3,200	3,583
Loss before Income Taxes	(1,484,739)	(5,468,648)	(1,106,135)
Income Tax Benefit		(1,245,353)	(544,032)
Net Loss	$ (1,484,739)	$ (4,223,295)	$ (562,103)
Net Loss per Common Share			
Basic	$ (0.11)	$ (0.32)	$ (0.04)
Diluted	$ (0.11)	$ (0.32)	$ (0.04)
Weighted Average Common and Common Equivalent Shares Outstanding			
Basic	13,346,915	13,238,778	12,746,973
Diluted	13,346,915	13,238,778	12,746,973

See accompanying notes to the consolidated financial statements.

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Covalent Group, Inc.

Consolidated Balance Sheets

	December 31, 2005	December 31, 2004
Assets		
Current Assets		
Cash and cash equivalents	$ 7,104,081	$ 3,165,986
Investigator advances	1,009	145,612
Accounts receivable, less allowance of $35,093 and $40,000 for 2005 and 2004, respectively	1,109,781	5,209,950
Prepaid expenses and other	312,408	158,287
Prepaid taxes	13,040	1,132,315
Costs and estimated earnings in excess of related billings on uncompleted contracts	383,598	1,667,947
Total Current Assets	8,923,917	11,480,097
Property and Equipment, Net	897,189	1,321,139
Other Assets	21,665	21,665
Total Assets	$ 9,842,771	$ 12,822,901
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 405,384	$ 1,101,788
Accrued expenses	231,249	392,385
Obligations under capital leases	26,314	23,709
Billings in excess of related costs and estimated earnings on uncompleted contracts	1,344,794	1,770,275
Customer advances	1,020,102	1,080,469
Total Current Liabilities	3,027,843	4,368,626
Long Term Liabilities		
Obligations under capital leases	36,995	63,309
Other liabilities	465,369	581,710
Deferred income tax		
Total Long Term Liabilities	502,364	645,019
Total Liabilities	3,530,207	5,013,645
Commitments and Contingencies		
Stockholders Equity		
Common stock, $.001 par value 25,000,000 shares authorized, 13,501,333 and 13,495,666 shares issued and outstanding respectively	13,502	13,496
Additional paid-in capital	12,028,415	12,017,822
Accumulated deficit	(5,418,116)	(3,933,377)
Accumulated other comprehensive income	147,737	170,289
	6,771,538	8,268,230
Less: Treasury stock, at cost, 152,932 shares	(458,974)	(458,974)
Total Stockholders Equity	6,312,564	7,809,256

Total Liabilities and Stockholders	**Equity**	$ 9,842,771	$ 12,822,901

See accompanying notes to the consolidated financial statements.

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Covalent Group, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Number of Common Shares	Par Value	Additional Paid-In Capital	Retained Earnings (Accum. Deficit)	Accum. Other Comprehensive Income	Treasury Stock at Cost	Total Stockholders Equity
Balance at December 31, 2002	12,664,583	$ 12,665	$ 10,887,759	$ 852,021	$ 26,344	$ (50,316)	$ 11,728,473
Net loss				(562,103)			(562,103)
Other comprehensive loss:							
Foreign currency translation adjustment					98,521		98,521
Total comprehensive loss:							(463,582)
Issuance of common shares exercise of stock options	570,900	570	484,915			(408,658)	76,827
Balance December 31, 2003	13,235,483	$ 13,235	$ 11,372,674	$ 289,918	$ 124,865	$ (458,974)	$ 11,341,718
Net loss				(4,223,295)			(4,223,295)
Other comprehensive loss:							
Foreign currency translation adjustment					45,424		45,424
Total comprehensive loss							(4,177,871)
Issuance of common shares exercise of stock options	260,183	261	645,148				645,409
Balance December 31, 2004	13,495,666	$ 13,496	$ 12,017,822	$ (3,933,377)	$ 170,289	$ (458,974)	$ 7,809,256
Net loss				(1,484,739)			(1,484,739)
Other comprehensive loss:							
Foreign currency translation adjustment					(22,552)		(22,552)
Total comprehensive loss:							(1,507,291)
Issuance of common shares exercise of stock options	5,667	6	10,593				10,599
Balance December 31, 2005	13,501,333	$ 13,502	$ 12,028,415	$ (5,418,116)	$ 147,737	$ (458,974)	$ 6,312,564

See accompanying notes to the consolidated financial statements.

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Covalent Group, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2005	**2004**	**2003**
Operating Activities:			
Net loss	$ (1,484,739)	$ (4,223,295)	$ (562,103)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	510,338	758,779	877,623
Changes in assets and liabilities:			
Investigator advances	144,603	458,573	(184,394)
Accounts receivable	4,100,169	499,376	1,877,249
Prepaid expenses and other	(154,121)	8,035	214,082
Prepaid Taxes	1,119,275	135,186	(1,267,501)
Costs and estimated earnings in excess of related billings on uncompleted contracts	1,284,349	7,073,017	283,890
Other assets			600
Accounts payable	(696,404)	(2,443,251)	789,519
Accrued expenses	(161,136)	128,721	(140,071)
Other Liabilities	(116,341)	(116,340)	
Income taxes payable			(111,646)
Deferred taxes		(211,040)	(133,185)
Billings in excess of related costs and estimated earnings on uncompleted contracts	(425,481)	588,849	(636,271)
Customer advances	(60,367)	(1,952,289)	(580,098)
Net Cash Provided by Operating Activities	4,060,145	704,321	427,694
Investing Activities:			
Purchases of property and equipment	(86,388)	(274,587)	(580,755)
Net Cash Used In Investing Activities	(86,388)	(274,587)	(580,755)
Financing Activities:			
Net repayments under capital leases	(23,709)	(24,268)	(74,039)
Proceeds from exercise of stock options	10,599	645,409	76,827
Net Cash Provided (Used) By Financing Activities	(13,110)	621,141	2,788
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(22,552)	45,424	98,521
Net Increase (Decrease) In Cash and Cash Equivalents	3,938,095	1,096,299	(51,752)
Cash and Cash Equivalents, Beginning of Period	3,165,986	2,069,687	2,121,439
Cash and Cash Equivalents, End of Period	$ 7,104,081	$ 3,165,986	$ 2,069,687

See accompanying notes to the consolidated financial statements.

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Covalent Group, Inc.

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS:

In this discussion, the terms, Company , we , us , and our , refer to Covalent Group, Inc. and subsidiaries, except where it is made clear otherwise.

We are a clinical research organization which is a leader in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. Our mission is to provide our clients with high quality, full-service support for their clinical trials. We offer therapeutic expertise, experienced team management and advanced technologies. Our headquarters is based in Wayne, Pennsylvania and our International operations are in London, England.

Our clients consist of many of the largest companies in the pharmaceutical, biotechnology and medical device industries. From protocol design and clinical program development, to proven patient recruitment, to managing the regulatory approval process, we have the resources to directly implement or manage Phase I through Phase IV clinical trials and to deliver clinical programs on time and within budget. We have clinical trial experience across a wide variety of therapeutic areas such as cardiovascular, endocrinology/metabolism, diabetes, neurology, oncology, immunology, vaccines, infectious diseases, gastroenterology, dermatology, hepatology, womens health and respiratory medicine. We have the capacity and expertise to conduct clinical trials on a global basis.

In November 2000, we established Covalent Group, Ltd., a wholly-owned subsidiary in the United Kingdom, to support existing contracts on clinical trials and expand our presence internationally. We were incorporated in August 1989 in Nevada and in June 2002, the Company changed its state of incorporation to Delaware.

The Company has incurred losses in recent years. However, we believe we will be able to return to being a profitable business as a result of anticipated new business awards combined with a leaner cost structure, increased backlog and a more favorable mix of existing contracts. Management believes that cash on hand and cash from operations will be sufficient to meet the Company s obligations for the foreseeable future. In the event that we are not able to develop new business or existing contracts are terminated, there is a potential risk that the Company will not achieve profitability and, accordingly, might not be able to meet future cash obligations. There can be no assurance that anticipated new business will be obtained and if such business is not obtained our financial results and cash flow could be adversely and materially affected.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates

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

Consolidation

The consolidated financial statements for 2005, 2004 and 2003 include our accounts and the accounts of our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Cash and Cash Equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Investigator Advances

We received advance payments from one of our clients as part of a long-term contract, which includes a separate cash account to be utilized for payment of investigator fees. As of December 31, 2005 and 2004, this cash amount was $1 thousand and $146 thousand, respectively. This amount is also included in customer advances in the accompanying balance sheets.

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Revenue Recognition

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

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

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

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

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

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the commencement, postponement and termination of engagements in the quarter, the mix of revenue, the extent of cost overruns, employee hiring, 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 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 exclude from revenue and expense in the Consolidated Statement of Operations fees paid to investigators and the associated reimbursement since we act as agent on behalf of our clients with regard to investigators. 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 $1.2 million, $5.1 million, and $10.5 million for the years ended December 31, 2005, 2004, and 2003 respectively.

Accounts Receivable

Accounts receivable and costs and estimated earnings in excess of related billings on completed contracts represent amounts due from our clients who are concentrated primarily in the pharmaceutical, biotechnology and medical device industries. Included in accounts receivable are amounts due from clients in connection with unbilled out-of-pocket pass-through costs in the amount of $94 thousand as of December 31, 2005 and $150 thousand as of December 31, 2004.

Concentration of Credit Risk

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a small number of companies within the pharmaceutical, biotechnology and medical device industries. The significant majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of December 31, 2005, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $1.5 million. Of this amount, the exposure to our three largest clients was 84% of the total, with the three largest clients representing 42%, 29%, and 13% of total exposure, respectively. As of December 31, 2004, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $6.9 million. Of this amount, the exposure to our three largest clients was 55% of the total, with the three largest clients representing 34%, 11%, and 10% of total exposure, respectively.

Financial Instruments

The fair value of cash and cash equivalents, restricted cash, accounts receivable, costs and estimated earnings in excess of related billings on uncompleted contracts, accounts payable, accrued expenses and billings in excess of related costs and estimated earnings on uncompleted contracts were not materially different than their carrying amounts as reported at December 31, 2005 and December 31, 2004.

As of December 31, 2005, the Company was not a counterparty to any forward foreign exchange contracts or any other transaction involving a derivative financial instrument.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from 3 to 8 years for equipment and furniture and fixtures and the remaining lease term for leasehold improvements and assets under capital lease. Depreciation and amortization for the years ended December 31, 2005, 2004 and 2003 was $510 thousand, $759 thousand and $878 thousand, respectively. Expenditures for maintenance and repairs are charged to expense as incurred. When assets are sold, retired, or fully depreciated the cost and accumulated depreciation are removed from the accounts, and any gain or loss on the sale of property and equipment is included in operations.

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Operating Expenses

Direct expenses include amounts incurred during the period that are directly related to the management or completion of a clinical trial or related project and generally include direct labor and related benefit charges, other direct costs and certain allocated expenses. Direct costs as a percentage of net revenues tend to fluctuate from one period to another, as a result of changes in the mix of services provided and the various studies conducted during any time period. Selling, general and administrative expenses include the salaries, wages and benefits of all administrative, finance and business development personnel, and all other support expenses not directly related to specific contracts.

Stock-Based Compensation

The Company has adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants. We account for grants of options to employees and directors under these plans applying the intrinsic value method provided for in Accounting Principles Board (APB) Opinion No. 25 Accounting for Stock Issued to Employees and related interpretations. No stock-based compensation expense is reflected in net income as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. In addition to APB Opinion No. 25, we provide the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 123 Accounting for Stock-Based Compensation and by SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. See Note 10.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation to stock-based employee compensation:

	Year Ended December 31,		
	2005	2004	2003
Net Loss as reported	$ (1,484,739)	$ (4,223,295)	$ (562,103)
Deduct: Pro forma stock-based compensation expense determined under the fair value method, net of related tax effects	(647,485)	(306,769)	(477,056)
Pro forma Net Loss	$ (2,132,224)	$ (4,530,064)	$ (1,039,159)
Net Loss Per Share			
Basic as reported	$ (0.11)	$ (0.32)	$ (0.04)
Basic pro forma	$ (0.16)	$ (0.34)	$ (0.08)
Diluted as reported	$ (0.11)	$ (0.32)	$ (0.04)
Diluted pro forma	$ (0.16)	$ (0.34)	$ (0.08)

Foreign Currency Translation

Assets and liabilities of the Company s international operations are translated into U.S. dollars at exchange rates in effect on the balance sheet date and equity accounts are translated at historical exchange rates. Revenue and expense items are translated at average exchange rates in effect during the year. Gains or losses from translating foreign currency financial statements are recorded in other comprehensive income. The cumulative translation adjustment included in other comprehensive income for the years ended December 31, 2005, December 31, 2004 and December 31, 2003 was $23 thousand, $45 thousand, and $99 thousand, respectively.

Income Taxes

The Company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes . SFAS No. 109 requires recognition of deferred tax liabilities and assets for the future expected tax consequences of events that have been included in the financial statements or tax returns. Under this method deferred tax liabilities and assets are determined based on the difference between the financial statement tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. At December 31, 2005, the Company recorded a full valuation allowance against its net deferred tax assets and net operating loss carry-forwards given that it is more likely than not that the deferred tax asset will not be realized.

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Earnings (Loss) Per Share

Earnings (loss) per share is calculated in accordance with SFAS No. 128, Earnings Per Share. Basic earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares plus the dilutive effect of warrants and outstanding stock options under the Company s equity incentive plans. For 2005, 2004 and 2003 diluted net loss per common share is the same as basic net loss per common share, since the effects of potentially dilutive securities are antidilutive.

Supplemental Cash Flow Information

Cash paid for income taxes net of refunds for the years ended December 31, 2005, 2004, and 2003 was $0, $0, and $1.0 million, respectively. Cash paid for interest for the years ended December 31, 2005, 2004, and 2003 was $10 thousand, $10 thousand, and $13 thousand, respectively. We entered into capital leases with obligations totaling $0, $0, and $123 thousand during the years ended December 31, 2005, 2004, and 2003, respectively.

The acquisition of property and equipment through lease incentives totaled $0 for years ended December 31, 2005 and 2004, respectively. During 2003, acquisition of property and equipment through lease incentives totaled $814 thousand.

On July 31, 2003, Dr. Borow, President and Chief Executive Officer of Covalent Group, Inc., exercised an employee stock option to acquire 500,000 shares of Covalent common stock. The option had a grant date of August 6, 1998, an expiration date of August 5, 2003 and an exercise price of $0.6875. As payment for the shares issued and related withholding taxes, Covalent Group, Inc. received from Dr. Borow 140,432 Covalent common shares that were owned by him. The shares received by the Company are included as treasury stock in our Consolidated Balance Sheet at December 31, 2005 and 2004.

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

Recently Issued Accounting Standards

In January 2003, the FASB issued Financial Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities an Interpretation of ARB No. 51. FIN 46 addresses consolidation by business enterprises of variable interest entities. In December 2003, the FASB then issued FIN 46(R), Consolidation of Variable Interest Entities an Interpretation of ARB No. 51, which replaced FIN 46. Application of FIN 46(R) was required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public entities for all other types of entities are required in financial statements for periods ending after March 15, 2004. The Company had adopted both FIN 46 and FIN 46(R), and the adoption had no impact on the Company s financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. The provisions of SFAS No. 149 that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. The Company has not entered into any derivative transactions and therefore the adoption of this standard has not had a material impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity , which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope, which may have previously been reported as equity, as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of SFAS No. 150 has not had a material impact on our financial statements.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment SFAS No. 123(R) revises SFAS 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to

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Employees , and its related implementation guidance. SFAS 123(R) will require compensation costs related to share-based payment transactions to be recognized in the financial statements. The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. This statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company is currently evaluating the impact from this standard on its future results of operations and financial position.

3. PROPERTY & EQUIPMENT:

	December 31, 2005	2004
Property & equipment consists of the following:		
Equipment	$ 976,917	$ 894,055
Furniture & fixtures	318,579	321,120
Leasehold improvements	1,016,581	1,016,581
Equipment under capital lease	123,000	123,000
	2,435,077	2,354,756
Accumulated depreciation	(1,537,888)	(1,033,617)
Property and equipment, net	$ 897,189	$ 1,321,139

The Company purchased $86 thousand of additional equipment in 2005. There was a reduction in net book value of UK assets due to foreign exchange rate differences totaling $6 thousand. At the end of 2004, the Company removed approximately $2.9 million of property and equipment from the accounts which was fully depreciated at the time of removal. The balance sheet and income statement impact of this removal on the net amount of property and equipment was zero for the year ended December 31, 2004. The removal of this property and equipment was a result of the Company determining that there was no future economic value of the property and equipment.

4. INCOME TAXES:

The components of the income tax (benefit) provision are as follows:

	Year Ended December 31, 2005	2004	2003
Current:			
Federal	$	$ (1,034,313)	$ (406,859)
State			(3,988)
		(1,034,313)	(410,847)
Deferred:			
Federal		(192,730)	(96,103)
State		(18,310)	(37,082)
		(211,040)	(133,185)
	$	$ (1,245,353)	$ (544,032)

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The federal statutory income tax rate is reconciled to the effective income tax rate as follows:

	Year Ended December 31,		
	2005	2004	2003
Federal statutory rate		(34.0)%	(34.0)%
State income taxes, net of federal benefit			(3.0)%
Adjustment to prior year accrual			(12.0)%
Increase in valuation allowance		11.2%	
Other			(.02)%
		(22.8)%	(49.2)%

The components of the net current and long-term deferred tax assets and liabilities, measured under SFAS No. 109, are as follows:

	Year Ended December 31,		
	2005	2004	2003
Deferred Tax Asset			
Long Term contract revenue	$	$	$
Investment valuation			
Net Operating Losses			61,029
Other			
			61,029
Deferred tax liabilities			
Depreciation			(79,339)
Accrual			(192,730)
Other			
			(272,069)
Net deferred tax liability	$	$	$ (211,040)

As of December 31, 2005, the Company had federal and state net operating loss carryforwards of approximately $2,039,000 and $6,300,000, respectively. These net operating loss and credit carryforwards have begun to expire and will continue to expire through 2024.

	2005	2004
Deferred tax assets		
Net Operating loss carryforward	$ 1,071,000	$ 705,109
Depreciation	(15,900)	(15,936)
Accrual	13,300	15,184
Total deferred tax assets	1,068,400	704,357
Valuation allowance	1,068,400	704,357
Net deferred tax assets	$	$

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Due to the Company s recent loss history, and uncertainty regarding the

realization of deferred tax assets, deferred tax assets have been fully reserved as of December 31, 2005. The utilization of federal net operating loss carryforwards is subject to annual limitations in accordance with Section 382 of the Internal Revenue code. Certain state carryforward net operating losses are also subject to annual limitations.

5. LINE OF CREDIT:

We previously maintained a demand line of credit with a bank under which maximum borrowings were the lesser of $2.5 million or 75% of eligible accounts receivable, as defined in the loan agreement, and interest was charged at the LIBOR Market Index Rate plus 2.65%. This line of credit expired on August 15, 2004.

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6. EARNINGS (LOSS) PER SHARE:

Earnings (loss) per share is calculated in accordance with SFAS No. 128, Earnings Per Share. Basic earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares plus the dilutive effect of outstanding stock options under the Company s equity incentive plans. For 2005, 2004 and 2003, diluted net loss per common share is the same as basic net loss per share, since the effects of potentially dilutive securities are anitdilutive. Stock options outstanding that are not included in the table below because of their anti-dilutive effect for the year ended December 31, 2005 were 22,213, for the year ended December 31, 2004 were 814,150 and for the year ended December 31, 2003 were 1,351,946.

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

	Year Ended December 31,		
	2005	2004	2003
Net Loss	$ (1,484,739)	$ (4,223,295)	$ (562,103)
Weighted average number of common shares outstanding used in computing basic earnings per share	13,346,915	13,238,778	12,746,973
Dilutive effect of stock options outstanding			
Weighted average shares used in computing diluted earnings per share	13,346,915	13,238,778	12,746,973
Basic loss per share	$ (0.11)	$ (0.32)	$ (0.04)
Diluted loss per share	$ (0.11)	$ (0.32)	$ (0.04)

7. STOCKHOLDERS EQUITY:

Treasury Stock

We have 152,932 common shares in treasury. The shares are valued using the cost method of accounting for treasury stock.

8. EXERCISE OF EMPLOYEE STOCK OPTION

On July 31, 2003, Dr. Borow, President and Chief Executive Officer of Covalent Group, Inc., exercised an employee stock option to acquire 500,000 shares of Covalent common stock. The option had a grant date of August 6, 1998, an expiration date of August 5, 2003 and an exercise price of $0.6875. As payment for the shares issued and related withholding taxes, Covalent Group, Inc. received from Dr. Borow 140,432 Covalent common shares that were owned by him. The shares received by the Company are included as treasury stock in our Consolidated Balance Sheet at December 31, 2005 and 2004.

9. STOCK-BASED COMPENSATION:

We have adopted equity incentive plans that provide for the granting of stock options to employees, directors, advisors and consultants. We account for grants of options to employees and directors under these plans applying the intrinsic value method provided for in Accounting Principles Board (APB) Opinion No. 25 Accounting for Stock Issued to Employees and related interpretations. No stock-based compensation expense is reflected in net income as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. In addition to APB Opinion No. 25, we provide the disclosures required by SFAS No. 123 Accounting for Stock-Based Compensation and by SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. See Note 2 for disclosure of Pro Forma Net Loss and Net Loss- Per Share.

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For purposes of determining the pro forma amounts in Note 2, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Year Ended December 31,		
	2005	2004	2003
Risk-free interest rate	3.63% - 4.24%	2.85% - 3.91%	2.11% - 3.54%
Expected dividend yield			
Expected life	5 years	5 years	5 years
Expected volatility	45%	56%	49%

Based upon the above assumptions, the weighted average fair value of the stock options granted for the years ended December 31, 2005, 2004, and 2003 was $1.02, $1.56, and $1.01 respectively. As of December 31, 2005, the weighted average remaining contractual life of stock options outstanding was 3.3 years. Because additional option grants are expected to be made each year, the above pro forma disclosures are not representative of pro forma effects on reported net income for future years.

2002 Equity Incentive Plan

In March 2002, the Board of Directors approved the 2002 Equity Incentive Plan, which was approved by the shareholders in June 2002. Upon adoption, a total of 1,000,000 shares were available for grant under this plan. The plan provides for the granting of incentive and non-qualified stock options for the purchase of shares of common stock to directors, officers, employees, advisors and consultants, as defined under the provisions of the plan.

1996 Equity Incentive Plan

The Company s 1996 Stock Incentive Plan and 1995 Stock Option Plan provide for the granting of incentive and non-qualified stock options for the purchase of shares of common stock to directors, officers, employees and consultants, as defined under the provisions of the plans. The 1996 Stock Incentive Plan was amended in 2000 to increase the number of common shares available for grant from 2,500,000 to 3,000,000. The stock incentive plan provides for the granting of incentive and non-qualified stock options for the purchase of shares of common stock to directors, employees and non-employee consultants, as defined under the provisions of the plan.

Aggregate stock option activities for all plans for the years ended December 31, 2005, 2004, and 2003 were as follows:

	Number of Shares	Range of Exercise Prices per Share	Weighted Average Exercise Price per Share
Options outstanding at January 1, 2003	2,404,272	$0.69 - 4.49	$2.68
Granted	354,000	2.05 - 2.59	2.20
Exercised	(570,900)	0.69 - 2.19	0.85
Canceled	(438,376)	1.94 - 4.47	2.78
Options outstanding at December 31, 2003	1,748,996	$1.80 - 4.49	$3.15
Granted	274,450	2.23 - 3.93	3.04
Exercised	(260,183)	1.94 - 2.86	2.49
Canceled	(282,071)	1.80 - 4.39	3.03
Options outstanding at December 31, 2004	1,481,192	$1.80 - 4.49	$3.27
Granted	776,250	2.05 - 2.82	2.25
Exercised	(5,667)	1.80 - 2.17	1.91
Canceled	(888,902)	1.94 - 4.38	3.57
Options outstanding at December 31, 2005	1,362,873	$1.94 - 4.49	$2.50
Exercisable options outstanding at:			
December 31, 2003	984,225	$ 1.80 -4.49	$3.36
December 31, 2004	1,014,711	$ 1.80 -4.49	$3.45

December 31, 2005	440,797	$ 1.94 -4.49	$2.70

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The following table summarizes information regarding stock options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding At December 31, 2005	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price per Share	Number Exercisable December 31, 2005	Weighted Average Exercise Price
$1.94	87,540	0.2	$1.94	87,540	$1.94
2.05-2.50	900,233	4.2	2.27	95,956	2.33
2.59-2.90	168,600	1.4	2.80	139,734	2.83
3.00-3.19	86,500	1.1	3.17	72,900	3.17
3.50-3.69	110,000	3.6	3.68	36,667	3.68
4.00-4.49	10,000	1.3	4.49	8,000	4.49
	1,362,873	3.3	$2.50	440,797	$2.70

As of December 31, 2005, there were 706,026 stock options available for grant under our stock option plans.

10. EMPLOYEE BENEFIT PLAN:

The Company sponsors a 401(k) retirement savings plan that is available to substantially all its U.S. based full-time employees who elect to participate. Effective January 1, 2003, the Company began providing a matching contribution equal to 50% on the first 2% of the participant s compensation (excluding bonus payments). In 2005 and 2004 company matching contributions were $26 thousand and $39 thousand, respectively. Matching contributions are determined each payroll period. The matching contribution is credited to the participant using a graded vesting schedule with six or more years of service required to become fully vested. The method for crediting vesting service is the plan year.

11. SEGMENT DISCLOSURES:

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 in one segment 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.

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

	Year Ended December 31,					
	2005		2004		2003	
	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts
Client A	27%	3	23%	3	41%	12
Client B	26	4	19	5	21	3
Client C	17	7	15	2	7	1
Client D	13	3	0	0	0	0
Top Four Clients	83%	17	57%	15	69%	16

Client A, B, C and D in the table above represent the four largest clients for 2005, but do not necessarily represent the same client for each year shown.

The significant clients above represented 72% and 2%, respectively, of the balance of cost and estimated earnings in excess of related billings on uncompleted contracts at December 31, 2005 and 2004.

The following table summarizes the distribution of net revenues from external clients by geographical area:

	Year Ended December 31,		
	2005	**2004**	**2003**
U.S.	$ 9,720,665	$ 12,264,999	$ 19,678,729
Europe	682,414	1,324,615	1,157,013
Total	$ 10,403,079	$ 13,589,614	$ 20,835,742

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12. CAPITAL AND OPERATING LEASE COMMITMENTS:

We entered into no new capital lease obligations during 2005. Leased equipment accounted for as a capital lease at December 31, 2005 totaled $123,000 with associated accumulated amortization of $67,650.

Future minimum lease payments on capital lease obligations at December 31, 2005 are as follows:

For the year ending December 31:	
2006	31,704
2007	31,704
2008	7,926
Total	$ 71,334
Less amount representing interest	(8,025)
Present value of capital lease payments	$ 63,309

We are committed under a number of non-cancelable operating leases, primarily related to office space and other office equipment. Total lease expense was $932 thousand for the year ended December 31, 2005, $922 thousand for the year ended December 31, 2004, and $987 thousand for the year ended December 31, 2003.

Future minimum lease payments on operating lease obligations at December 31, 2005, are as follows:

	Total	1 Year	2-3 Years	4-5 Years	> 5 Years
Operating leases	$ 3,917,549	$ 966,619	$ 1,981,189	$ 969,741	$

13. OTHER LIABILITIES

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. 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 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.

14. QUARTERLY FINANCIAL DATA (UNAUDITED):

	For the Quarter Ended			
	March 31	June 30	September 30	December 31
2005				
Net Revenues	$ 3,213,529	$ 2,328,379	$ 2,713,702	$ 2,147,469
Loss From Operations	(113,103)	(501,722)	(290,787)	(719,488)
Net Loss	(98,472)	(483,074)	(244,363)	(658,830)
Net Loss Per Common Share				
Basic	$ (0.01)	$ (0.04)	$ (0.02)	$ (0.05)
Diluted	$ (0.01)	$ (0.04)	$ (0.02)	$ (0.05)

2004				
Net Revenue	$ 5,282,585	$ 3,778,774	$ 1,876,406	$ 2,651,849
Income (Loss) From Operations	29,665	(1,951,200)	(2,148,791)	(1,401,522)
Net Income (Loss)	27,105	(1,446,730)	(1,443,314)	(1,360,356)
Net Loss Per Common Share				
Basic	$	$ (0.11)	$ (0.11)	$ (0.10)
Diluted	$	$ (0.11)	$ (0.11)	$ (0.10)

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15. COMMITMENTS AND CONTINGENCIES:

We have entered into an employment agreement with one of our officers that calls for specified minimum annual compensation of $325,000 per year over a three-year period and includes provisions for continuation of salary upon termination as defined in the agreement. This agreement will expire on March 31, 2006.

The contract research organization industry is subject to legislation and regulations that are revised or amended on an on-going basis. The impact of complying with such legislation and regulations could materially affect our business.

As discussed in Item. 7, and as set forth in the table below, the Company is obligated under outsourcing agreements related to certain aspects of its support functions, which are reflected as purchase obligations in the table below. Actual amounts paid under these outsourcing agreements could be higher or lower than the amounts shown below as a result of changes in volume and other variables.

		Payments due by period			
Contractual Obligations	**Total**	**<1 Year**	**1-3 Years**	**3-5 Years**	**>5 years**
Purchase Obligations	$ 934,286	$ 338,077	$ 449,285	$ 146,924	$

16. SUBSEQUENT EVENTS:

In March 2006, we announced the signing of a Combination Agreement with Remedium OY (Remedium), a privately owned, full service CRO based in Espoo, Finland with offices in 8 countries throughout Scandinavia, Central Europe and Eastern Europe. Under the terms of the Agreement, we expect to pay approximately $20 million for all of the outstanding shares and common stock equivalents of Remedium. The consideration for the transaction is expected to be in the form of Company shares in the amount of $16 million and $4 million in cash, subject to certain purchase price adjustments. The closing of the transaction is expected to occur at the end of the second quarter of 2006 subject to certain contingencies including, but not limited to, the approval of our shareholders and a scheduled new fundraising for at least $4 million to help finance the transaction. In connection with the transaction, we plan to change our name to Encorium BioSolutions, Inc. and apply for a new ticker symbol in connection with our name change.

During the year ended December 31, 2005, the Company incurred approximately $122,000 of costs related to the Remedium acquisition which it charged to selling, general and administrative expense. The costs were primarily for professional fees related to the acquisition as well as travel related expenses.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

COVALENT GROUP, INC.

Dated: March 29, 2006

By: /s/ KENNETH M. BOROW, M.D.
Kenneth M. Borow, M.D.

President, Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: March 29, 2006

By: /s/ KENNETH M. BOROW, M.D.
Kenneth M. Borow, M.D.

President, Chief Executive Officer and Director

Dated: March 29, 2006

By: /s/ LAWRENCE R. HOFFMAN
Lawrence R. Hoffman

Executive Vice President, General Counsel,

Secretary and Chief Financial Officer

Dated: March 29, 2006

By: /s/ EARL M. COLLIER, JR.
Earl M. Collier, Jr.

Director

Dated: March 29, 2006

By: /s/ SCOTT M. JENKINS
Scott M. Jenkins

Director

Dated: March 29, 2006

By: /s/ CHRISTOPHER F. MESHGINPOOSH
Christopher F. Meshginpoosh

Director

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Covalent Group, Inc.

Financial Statement Schedule

Schedule II

COVALENT GROUP, INC.

VALUATION AND QUALIFYING ACCOUNTS

(IN THOUSANDS)

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	ADDITIONS CHARGED TO COSTS AND EXPENSES	DEDUCTIONS	BALANCE AT END OF PERIOD
YEAR ENDED DECEMBER 31, 2005				
Allowance for doubtful accounts	$ 40	$	$ 5	$ 35
YEAR ENDED DECEMBER 31, 2004				
Allowance for doubtful accounts	$	$ 301	$261	$ 40
YEAR ENDED DECEMBER 31, 2003				
Allowance for doubtful accounts	$ 11	$	$ 11	$

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EXHIBIT INDEX

Exhibit	Description
2.1	Combination agreement between Covalent Group, Inc. and the Remedium Stockholders.
10.13	Lease agreement between Ealing Studios and Covalent Group Limited dated March 7, 2006.
21	Subsidiaries of the Registrant.
23	Consent of Deloitte & Touche LLP.
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.