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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2004.

**TRANSITION REPORT PURSUANT TO 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

*Commission file number: 0-21145*

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**COVALENT GROUP, INC.**

(Exact name of registrant as specified in its charter)

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Delaware

56-1668867

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(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

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**

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date: As of August 1, 2004 there were 13,323,669 shares of Covalent Group, Inc. common stock outstanding, par value \$.001 per share, excluding 152,932 shares in treasury.

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**COVALENT GROUP, INC.**

**INDEX**

	<u>Page</u>
<b>PART I. <u>Financial Information</u></b>	
Item 1. <u>Consolidated Financial Statements (unaudited)</u>	
<u>Consolidated balance sheets</u> <u>June 30, 2004 and December 31, 2003</u>	1
<u>Consolidated statements of operations</u> <u>Three and six months ended June 30, 2004 and 2003</u>	2
<u>Consolidated statements of cash flows</u> <u>Six months ended June 30, 2004 and 2003</u>	3
<u>Notes to consolidated financial statements</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	18
Item 4. <u>Controls and Procedures</u>	19

PART II.	<u>Other Information</u>	
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	19
Item 6.	<u>Exhibits and Reports on Form 8-K</u>	19
<u>SIGNATURES</u>		20

## PART I. FINANCIAL INFORMATION

### ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

#### Covalent Group, Inc.

#### Consolidated Balance Sheets

(Unaudited)

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 4,226,406	\$ 2,069,687
Restricted cash	882,683	604,185
Accounts receivable, net of allowance for doubtful accounts \$406,150 and \$0, respectively	5,361,018	5,872,137
Prepaid expenses and other	281,866	166,322
Prepaid taxes	1,345,714	1,074,771
Costs and estimated earnings in excess of related billings on uncompleted contracts	5,263,757	8,578,153
<b>Total Current Assets</b>	<b>17,361,444</b>	<b>18,365,255</b>
<b>Property and Equipment, Net</b>	<b>1,453,507</b>	<b>1,805,331</b>
<b>Other Assets</b>	<b>21,665</b>	<b>21,665</b>
<b>Total Assets</b>	<b>\$ 18,836,616</b>	<b>\$ 20,192,251</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 4,020,683	\$ 3,545,039
Accrued expenses	370,374	263,664
Obligations under capital leases	22,504	24,268
Billings in excess of related costs and estimated earnings on uncompleted contracts	1,137,150	1,181,426
Customer advances	1,995,961	3,032,758
<b>Total Current Liabilities</b>	<b>7,546,672</b>	<b>8,047,155</b>
<b>Long Term Liabilities</b>		
Obligations under capital leases	75,472	87,018
Other liabilities	639,880	698,050
Deferred income tax	18,310	18,310
<b>Total Long Term Liabilities</b>	<b>733,662</b>	<b>803,378</b>
<b>Total Liabilities</b>	<b>8,280,334</b>	<b>8,850,533</b>

<b>Stockholders Equity</b>		
Common stock, \$.001 par value 25,000,000 shares authorized, 13,476,601 and 13,235,483 shares issued respectively	13,476	13,235
Additional paid-in capital	11,980,262	11,372,674
Retained earnings (Deficit)	(1,129,707)	289,918
Accumulated other comprehensive income	151,225	124,865
<b>Less:</b>	<b>11,015,256</b>	<b>11,800,692</b>
Treasury stock, at cost, 152,932 shares	(458,974)	(458,974)
<b>Total Stockholders Equity</b>	<b>10,556,282</b>	<b>11,341,718</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 18,836,616</b>	<b>\$ 20,192,251</b>

See accompanying notes to the consolidated financial statements.

1

**Covalent Group, Inc.**

**Consolidated Statements of Operations**

**(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net revenue	\$ 3,778,774	\$ 5,732,295	\$ 9,061,359	\$ 12,119,357
Reimbursement revenue	2,618,378	933,637	4,258,511	1,948,833
<b>Total Revenue</b>	<b>\$ 6,397,152</b>	<b>\$ 6,665,932</b>	<b>\$ 13,319,870</b>	<b>\$ 14,068,190</b>
<b>Operating Expenses</b>				
Direct	4,002,847	3,870,719	7,678,427	7,772,970
Reimbursement out-of-pocket expenses	2,618,378	933,637	4,258,511	1,948,833
Selling, general and administrative	1,547,032	1,519,921	2,870,492	2,994,276
Depreciation and amortization	180,095	231,163	433,975	434,624
<b>Total Operating Expenses</b>	<b>8,348,352</b>	<b>6,555,440</b>	<b>15,241,405</b>	<b>13,150,703</b>
<b>Income (Loss) from Operations</b>	<b>(1,951,200)</b>	<b>110,492</b>	<b>(1,921,535)</b>	<b>917,487</b>
Interest Income	926	6,470	1,683	11,500
Interest Expense	(2,656)	(3,063)	(5,484)	(4,848)
<b>Net Interest Income (Expense)</b>	<b>(1,730)</b>	<b>3,407</b>	<b>(3,801)</b>	<b>6,652</b>
<b>Income (Loss) before Income Taxes</b>	<b>(1,952,930)</b>	<b>113,899</b>	<b>(1,925,336)</b>	<b>924,139</b>

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<b>Income Tax Provision (Benefit)</b>	(506,200)	43,000	(505,711)	371,147
<b>Net Income (Loss)</b>	<u>\$ (1,446,730)</u>	<u>\$ 70,899</u>	<u>\$ (1,419,625)</u>	<u>\$ 552,992</u>
<b>Net Income (Loss) per Common Share</b>				
<b>Basic:</b>	\$ (0.11)	\$ 0.01	\$ (0.11)	\$ 0.04
<b>Diluted:</b>	\$ (0.11)	\$ 0.01	\$ (0.11)	\$ 0.04
<b>Weighted Average Common and Common Equivalent Shares Outstanding</b>				
<b>Basic:</b>	13,213,297	12,655,851	13,147,924	12,653,977
<b>Diluted:</b>	13,213,297	13,060,766	13,147,924	13,040,137

See accompanying notes to the consolidated financial statements.

2

**Covalent Group, Inc.**

**Consolidated Statements of Cash Flows**

**(Unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>
	<u>          </u>	<u>          </u>
<b>Operating Activities:</b>		
Net income (loss)	\$ (1,419,625)	\$ 552,992
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	433,975	434,624
Changes in assets and liabilities;		
Restricted cash	(278,498)	(188,197)
Accounts receivable	511,119	1,241,462
Prepaid expenses and other	(115,544)	(463,904)
Prepaid taxes	(270,943)	
Costs and estimated earnings in excess of related billings on uncompleted contracts	3,314,396	1,858,916
Other assets		(4,323)
Accounts payable	475,644	733,772
Accrued expenses	106,710	(231,919)
Other liabilities	(58,170)	
Income taxes payable		(111,646)
Billings in excess of related costs and estimated earnings on uncompleted contracts	(44,276)	(830,563)
Customer advances	(1,036,797)	(244,927)
	<u>          </u>	<u>          </u>
<b>Net Cash Provided by Operating Activities</b>	<b>1,617,991</b>	<b>2,746,287</b>
	<u>          </u>	<u>          </u>
<b>Investing Activities:</b>		
Purchases of property and equipment	(82,151)	(546,476)
	<u>          </u>	<u>          </u>
<b>Net Cash Used In Investing Activities</b>	<b>(82,151)</b>	<b>(546,476)</b>
	<u>          </u>	<u>          </u>

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<b>Financing Activities:</b>		
Net repayments and borrowings under capital leases	(13,310)	(36,301)
Proceeds from exercise of stock options	607,829	25,042
	<u>          </u>	<u>          </u>
<b>Net Cash Provided By (Used) In Financing Activities</b>	<b>594,519</b>	<b>(11,259)</b>
	<u>          </u>	<u>          </u>
<b>Effect of Exchange Rate Changes on Cash and Cash Equivalents</b>	<b>26,360</b>	<b>26,653</b>
<b>Net Increase In Cash and Cash Equivalents</b>	<b>2,156,719</b>	<b>2,215,205</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>2,069,687</b>	<b>2,121,439</b>
	<u>          </u>	<u>          </u>
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 4,226,406</b>	<b>\$ 4,336,644</b>
	<u>          </u>	<u>          </u>

See accompanying notes to the consolidated financial statements.

3

Covalent Group, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

Basis of Presentation

The accompanying unaudited financial statements for the three and six months ended June 30, 2004 and June 30, 2003 have been prepared in accordance with accounting principles generally accepted in the United States of America ( generally accepted accounting principles ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (primarily consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2004 may not necessarily be indicati