

ENCORIUM GROUP INC
Form 10-Q
November 16, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009.

OR

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

For the transition period from _____ to _____

Commission file number: 0-21145

ENCORIUM GROUP, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

400 Berwyn Park
899 Cassatt Road, Suite 115,
Berwyn, Pennsylvania
(Address of principal executive offices)

56-1668867
(I.R.S. Employer
Identification No.)

19312
(Zip Code)

610-989-4208

(Registrant's telephone number, including area code)

One Glenhardie Corporate Center, 1275 Drummers Lane,
Suite 300, Wayne, Pennsylvania

(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 16, 2009, there were 26,325,383 shares of Encorium Group, Inc. common stock issued, par value \$.001 per share, which excludes 310,121 shares in treasury.

Table of Contents

ENCORIUM GROUP, INC.

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
ITEM 1.	
<u>Consolidated Condensed Financial Statements (unaudited)</u>	
<u>Consolidated condensed balance sheets September 30, 2009 and December 31, 2008</u>	2
<u>Consolidated condensed statements of operations Three and Nine months ended September 30, 2009 and 2008</u>	3
<u>Consolidated condensed statements of cash flows Nine months ended September 30, 2009 and 2008</u>	4
<u>Notes to consolidated condensed financial statements</u>	5
ITEM 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
ITEM 4T.	
<u>Controls and Procedures</u>	20
<u>PART II. OTHER INFORMATION</u>	
ITEM 1A.	
<u>Risk Factors</u>	20
ITEM 6.	
<u>Exhibits</u>	25
<u>SIGNATURES</u>	S-1

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ENCORIUM GROUP, INC.****CONSOLIDATED CONDENSED BALANCE SHEETS****(UNAUDITED)**

	September 30, 2009	December 31, 2008
Assets		
Current Assets		
Cash and cash equivalents	\$ 318,243	\$ 5,705,818
Investigator advances	29,289	1,088,768
Accounts receivable, less allowance of \$220,000 and \$97,000 for September 30, 2009 and December 31, 2008, respectively	3,137,422	4,624,161
Prepaid expenses and other	1,133,838	1,206,088
Prepaid taxes	40,670	28,290
Costs and estimated earnings in excess of related billings on uncompleted contracts	1,311,739	1,443,427
Total Current Assets	5,971,201	14,096,552
Property and Equipment, Net	303,940	1,211,929
Intangible Assets		
Goodwill	1,414,244	1,366,269
Other intangibles, Net	3,613,698	3,733,517
Other assets	314,992	684,666
Total Assets	\$ 11,618,075	\$ 21,092,933
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	\$ 2,684,547	\$ 3,624,071
Lines of credit	701,335	
Accrued expenses	2,671,716	3,004,627
Deferred taxes	612,987	206,173
Obligations under capital leases	48,154	72,542
Billings in excess of related costs and estimated earnings on uncompleted contracts	1,418,607	3,307,347
Customer advances	1,409,074	5,297,000
Total Current Liabilities	9,546,420	15,511,760
Long Term Liabilities		
Obligations under capital leases	79,268	189,680
Deferred taxes	842,250	897,204
Other liabilities	224,714	316,516
Total Long Term Liabilities	1,146,232	1,403,400

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Total Liabilities	10,692,652	16,915,160
Stockholders Equity		
Common stock, \$.001 par value 35,000,000 shares authorized, 20,834,004 shares issued and 20,523,883 shares outstanding	20,834	20,834
Additional paid-in capital	32,716,837	32,417,250
Additional paid-in capital warrants	905,699	905,699
Accumulated deficit	(32,877,972)	(29,737,430)
Accumulated other comprehensive income	886,714	1,298,109
Less:	1,652,112	4,904,462
Treasury stock, at cost, 310,121 shares	(726,689)	(726,689)
Total Stockholders Equity	925,423	4,177,773
Total Liabilities and Stockholders Equity	\$ 11,618,075	\$ 21,092,933

See accompanying notes to the consolidated condensed financial statements.

Table of Contents

ENCORIUM GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net revenue	\$ 4,446,606	\$ 5,396,894	\$ 13,468,042	\$ 16,716,964
Reimbursement revenue	661,176	1,116,818	2,576,542	3,085,554
Total Revenue	5,107,782	6,513,712	16,044,584	19,802,518
Operating Expenses				
Direct	2,905,878	3,519,946	9,270,853	11,026,826
Reimbursement out-of-pocket expenses	661,176	1,116,818	2,576,542	3,085,554
Selling, general and administrative	2,058,878	2,035,638	6,379,746	6,836,465
Depreciation and amortization	98,563	403,406	281,938	1,183,681
Impairment loss		1,856,183		1,856,183
Total Operating Expenses	5,724,495	8,931,991	18,509,079	23,988,709
Loss from Operations	(616,713)	(2,418,279)	(2,464,495)	(4,186,191)
Interest Income		1,071		13,756
Interest Expense	(26,676)	(17,129)	(31,132)	(24,044)
Net Interest Expense	(26,676)	(16,058)	(31,132)	(10,288)
Other expense				
Net Loss from continuing operations before Income Taxes	(643,389)	(2,434,337)	(2,495,627)	(4,196,479)
Income Tax Expense (Benefit)	98,826	(8,627)	90,899	60,269
Net Loss from continuing operations	\$ (742,215)	\$ (2,425,710)	\$ (2,586,526)	\$ (4,256,748)
Net Loss from discontinued operations	(258,436)	(1,455,642)	(554,016)	(3,077,435)
Income Tax Expense (Benefit)				
Net Loss	\$ (1,000,651)	\$ (3,881,352)	\$ (3,140,542)	\$ (7,334,183)
Weighted Average Common and Common Equivalent Shares Outstanding				
Basic	20,523,883	20,603,140	20,523,883	20,603,140
Diluted	20,523,883	20,603,140	20,523,883	20,603,140

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Net Loss per Common Share					
Continuing Operations	\$	(0.04)	\$	(0.12)	\$ (0.13) \$ (0.21)
Discontinued Operations	\$	(0.01)	\$	(0.07)	\$ (0.02) \$ (0.15)
Net Loss per Common Share	\$	(0.05)	\$	(0.19)	\$ (0.15) \$ (0.36)

See accompanying notes to the consolidated condensed financial statements.

Table of Contents**ENCORIUM GROUP, INC.****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	Nine Months Ended September 30,	
	2009	2008
Net Cash Used By Operating Activities	\$ (5,439,361)	\$ (3,487,433)
Investing Activities:		
Purchases of property and equipment	(41,817)	(248,525)
Net Cash Used By Investing Activities	(41,817)	(248,525)
Financing Activities:		
Net payments under capital leases	(79,830)	(22,883)
Net cash from short-term borrowings	701,335	52,040
Net Cash Provided By Financing Activities	621,505	29,157
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(527,902)	(35,928)
Net Decrease In Cash and Cash Equivalents	(5,387,575)	(3,742,729)
Cash and Cash Equivalents, Beginning of Period	5,705,818	9,109,456
Cash and Cash Equivalents, End of Period	\$ 318,243	\$ 5,366,727

See accompanying notes to the consolidated condensed financial statements.

Table of Contents

ENCORIUM GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

1. DESCRIPTION OF BUSINESS:

In this discussion, the terms, "Company", "we", "us", and "our", refer to Encorium Group, Inc. and subsidiaries (formerly known as, "Covalent Group, Inc."), except where it is made clear otherwise.

We are a clinical research organization that engages in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. We were initially incorporated in August 1998 in Nevada. In June 2002, we changed our state of incorporation to Delaware. In November 2006, we expanded our international operations with the acquisition of our wholly-owned subsidiary, Encorium Oy, a CRO founded in 1996 in Finland, which offers clinical trial services to the pharmaceutical and medical device industries. Since 2006 we have conducted substantially all of our European operations through Encorium Oy and its wholly-owned subsidiaries located in Denmark, Estonia, Sweden, Lithuania, Romania, Germany and Poland. On July 16, 2009 the Company sold substantially all of the assets relating to the Company's US line of business to Pierrel Research USA, Inc., the result of which the Company no longer has any employees or significant operations in the United States. Due to this sale, for the nine months ended September 30, 2009 and 2008, the results of the U.S. business have been presented as discontinued operations in the consolidated financial statements.

On October 19, 2009, we announced that we had completed a private placement of 3,937,500 shares of our common stock with a private investor for an aggregate purchase price of \$1,575,000 or \$0.40 per share.

Prior to the transaction, the Company entered into Warrant Exchange Agreements with two investors (the "Investors") pursuant to which the Company issued to the Investors an aggregate of 1,864,000 shares of Common Stock (collectively, the "Exchange Shares") and warrants to purchase an aggregate of 874,126 shares of Common Stock, exercisable for a period of five years, at an exercise price of \$0.40 per share (collectively, the "Exchange Warrants"). The Exchange Shares and Exchange Warrants were issued in exchange for warrants dated as of May 9, 2007 held by the Investors to purchase an aggregate of 874,126 shares of Common Stock of the Company (collectively, the "Original Warrants"). Except as described above, the terms of the Exchange Warrants, including anti-dilution adjustments, are substantially similar to those of the Original Warrants.

The Company also announced on October 19, 2009, that it has terminated previously announced negotiations for the sale of the Company's wholly-owned subsidiary Encorium OY to a clinical research organization based in the United States and will not pursue a sale of the Company or Encorium Oy at this time.

Historically our net cash used in operations has been substantial. Our net cash used in operations for the nine months ended September 30, 2009 was \$5.4 million. Our cash and cash equivalents as of September 30, 2009 was \$318 thousand. We anticipate that we will be able to meet our cash requirements through September of 2010, assuming we are able to fully implement our current cost cutting initiatives, we are able to win additional contracts during fiscal 2009 and we are able to maintain our current customer contracts. We will continue to seek strategic alternatives, including, but not limited to attempting to secure additional financing. Our ability to obtain additional financing in the future will depend in part upon prevailing capital market conditions, as well as conditions in our business and our operating results; and those factors may affect our efforts to arrange additional financing on terms that are satisfactory to us or at all. If we are unable to secure additional financing on terms acceptable to us and on a timely basis, we may significantly reduce our operating costs, which may include the cessation of operations in some countries. Our consolidated financial statements do not include any adjustment to reflect the possible future effects on the recoverability or classification of assets or the amounts and classification of liabilities that may result from the outcome of our ability to continue as a going concern.

The accompanying consolidated condensed financial statements have been prepared on the basis of the Company continuing as a going concern. However, the factors summarized above have raised substantial doubt about our ability to continue as a going concern for the foreseeable future.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

The accompanying unaudited Combined Condensed Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q. Certain information and accounting policies and footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such instructions, although Encorium believes that the included disclosures are adequate for a fair presentation. The information furnished reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary for a fair summary of the financial position, results of operations and cash flows for the interim periods presented. These Combined Condensed Financial Statements should be read in conjunction with the Combined Condensed Financial Statements and notes thereto filed with Form 10-K for the year ended December 31, 2008. Pursuant to FASB's authoritative guidance, subsequent events have been evaluated through November 16, 2009, the date these financial statements were available to be issued, and there were no subsequent events to be reported.

Use of Estimates

The preparation of consolidated financial statements in conformity with 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 condensed financial statements for the nine months ended September 30, 2009 and 2008 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.

We maintain cash accounts at several institutions in Europe and one in the US. Deposits in Europe are generally insured by individual states up to €50,000 for each account (approximately \$73,000 as of September 30, 2009). Accounts in the US are generally insured up to \$250,000 for each account. As of September 30, 2009 our cash and cash equivalents was based primarily in Europe with two institutions. To date, the Company has not experienced any loss or lack of access to its invested cash or cash equivalents, however, there can be no assurance that access to invested balances will not be impacted by adverse conditions in the financial and credit markets.

Investigator Advances

We received advance payments from a small number of our clients as part of certain long-term contracts, which require us to maintain separate cash accounts to be utilized for payment of investigator fees. As of September 30, 2009 and December 31, 2008, this cash amount was \$0 and \$1.1 million, respectively. This amount is also included in Customer Advances, a component of current liabilities, in the accompanying balance sheets.

Table of Contents

ENCORIUM GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Accounts Receivable

Accounts receivable, net of an allowance for doubtful accounts, consists of customer billings pursuant to contractual terms related to work performed as of September 30, 2009. In general, amounts become billable upon the achievement of billing mechanisms or in accordance with predetermined payment schedules set forth in the contracts with our clients. Included in accounts receivable are amounts due from clients in connection with unbilled out-of-pocket pass-through costs in the amount of \$ 0 as of September 30, 2009 and \$369 thousand as of December 31, 2008.

Concentration of Credit Risk

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a number of companies within the pharmaceutical, biotechnology and medical device industries. The majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of September 30, 2009, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was \$4.4 million. Of this amount, the exposure to our three largest clients was 54% of the total, with the three largest clients representing 27%, 16% and 11% of total exposure, respectively. As of December 31, 2008, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was \$6.1 million. Of this amount, the exposure to our three largest clients was 38% of the total, with the three largest clients representing 15%, 12%, and 11% of total exposure, respectively.

Customer Advances

Several client contracts contain provisions that allow us to bill and receive advance payments to be utilized for investigator fees and reimbursable expenses. In some instances, the client requires that we maintain separate cash accounts to be utilized for investigator fees, which are included as Investigator Advances as a component of current assets. Funds received as customer advances, excluding investigator advances for which separate cash accounts are required as part of our contract with the client, are included as part of Cash and cash equivalents. The balance of customer advances, including investigator advances of \$0, was \$1.4 million as of September 30, 2009. As of September 30, 2009, there were no material customer advances billed, but not received.

Revenue Recognition

A significant portion 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. Under some of our contracts work is performed under time and material contracts whereby we recognize revenue as hours are worked based on the hourly billing rate for each contract.

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 collectability 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 nine years. We may experience similar situations in the future, although our current contracts in process

are of a shorter duration and subject to less cost volatility. Should our estimated costs on fixed price contracts prove to be low in comparison to actual costs, future margins could be reduced, absent our ability to negotiate a contract modification. There are no standard billing and payment provisions which are present in each contract. Each contract has separate and distinct billing and payment terms which are the result of negotiation between us and the client. 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. The payment schedule in the contract reflects the value of services to be performed by us at the initiation of the contract. The payment schedule may include the value of certain interim service components as well as periodic payments which are reasonably assured at the start of the contract and which we expect to receive during the duration of the contract. Accordingly, cash receipts, including the receipt of up front payments, periodic payments and payments related to the achievement of certain billing mechanisms, do not necessarily correspond to cost incurred and revenue recognized on contracts. A contract's payment structure typically requires an upfront payment of 10% to 20% of the contract value at or shortly after the initiation of the contract, a series of periodic payments over the life of the contract and payments based upon the achievement of certain billing mechanisms. The upfront payments are deferred and recognized as revenues as services are performed under the proportional performance method. Periodic payments, including payments related to the achievement of certain billing mechanisms in the contract, are invoiced pursuant to the terms of the contract once the agreed upon services criteria have been achieved. Payments based upon interim billing mechanisms are included in the value of the contract because we expect to receive them during the term 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 service components separately but as an integrated, full service arrangement in connection with the development of the drug.

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

Our accounting policy for recognizing revenue for terminated projects requires us to perform a reconciliation of study activities versus the activities set forth in the contract. We negotiate with the client, pursuant to the terms of the existing contract, regarding the wind down 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 collectability 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 revenue 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. 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.

Table of Contents

ENCORIUM GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

As is customary in the industry, we will continue to exclude from revenue and expense in the Consolidated Statements of Operations fees paid to investigators and the associated reimbursement since we acts as an agent on behalf of the clinical trial sponsors with regard to investigator payments. These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of investigator fees for the three months ended September 30, 2009 and 2008 were \$54 thousand and \$1.2 million, respectively. The amount of investigator fees for the nine months ended September 30, 2009 and 2008 were \$1.0 million and \$4.5 million, respectively.

Stock-Based Compensation

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

Effective January 1, 2006, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 718 (ASC 718) using the Modified Prospective Approach. ASC 718 requires the costs for all share-based payments to employees, including grants of employee stock options, to be recognized in financial statements based on their fair values at grant date, or the date of later modification, over the requisite period. In addition, ASC 718 requires unrecognized cost (based on the amounts previously disclosed in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized in the financial statements over the remaining requisite period. Accordingly, prior period amounts have not been restated. See Note 8 for further detail regarding the adoption of this standard.

Goodwill and Intangible Assets

The Company follows the provisions of FASB ASC 805, *Business Combinations*, (ASC 805) and FASB ASC 350, *Goodwill and Other Intangible Assets*, (ASC 350) applicable to business combinations. The Company also follows the provisions of FASB ASC 360, *Accounting for the Impairment or Disposal of Long-Lived Assets*, (ASC 360) applicable to its accounting for impairment of goodwill and intangible assets. In accordance with these standards, goodwill acquired in connection with the acquisition of Encorium Oy (formerly Remedium) was not amortized. However, the identifiable intangible assets acquired in connection with the acquisition of Encorium Oy are being amortized over their useful lives. Under ASC 350, goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If carrying value exceeds current fair value, then goodwill is considered impaired and is reduced to fair value via a charge to earnings. The identifiable intangibles acquired in connection with the acquisition of Encorium Oy are also subject to impairment testing under ASC 350, whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. The Company performed its annual impairment testing as of November 1, 2008. The fair value of the reporting unit was estimated using the expected present value of future cash flows and market values of comparable companies using estimates, judgments and assumptions that Management believes were appropriate in the circumstances. The sum of the fair value was reconciled to the Company's current market capitalization. As a result of this reconciliation process the Company recorded an impairment charge related to goodwill of \$12.5 million in the fourth quarter of 2008. The Company will perform its next annual impairment testing as of November 1, 2009.

Foreign Currency Translation

The functional currency of the Company is the United States (U.S.) dollar. The functional currency of the Company's foreign operations generally is the applicable local currency for each foreign subsidiary. Assets and liabilities of foreign subsidiaries are translated at the spot rate in effect for the reporting date, and consolidated statements of operations are translated at the average exchange rates in effect during the applicable period. The resulting unrealized cumulative translation adjustment, net of applicable income taxes, is recorded as a component of accumulated other comprehensive income in stockholder's equity.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses which are reflected in the accompanying consolidated condensed statements of operations as unrealized (based on the applicable period exchange rate) or realized upon settlement of the transactions.

3. RECENTLY ISSUED ACCOUNTING STANDARDS:

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

In June 2009, the FASB issued an accounting standard codified within Accounting Standards Codification (ASC) ASC 105, *Generally Accepted Accounting Principles*, (ASC 105 and formerly referred to as SFAS No. 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. ASC 105 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. As ASC 105 is not intended to change or alter existing GAAP, it will not impact the Company's condensed financial statements. The Company has adjusted historical GAAP references in its third quarter 2009 Form 10-Q to reflect accounting guidance references included in the Codification.

In September 2009, the FASB issued Accounting Standards Update No. 2009-07 (ASC Update 2009-07) *Accounting for Various Topics - Technical Corrections to SEC Paragraphs*. This ASU represents technical corrections to various ASC Topics containing SEC guidance. The technical corrections resulted from external comments received, and consisted principally of paragraph referencing and minor wording changes. In the third quarter of 2009, the Company adopted this FASB ASU. The adoption of this ASU did not have any impact on the condensed financial statements included herein.

In December 2007, the FASB issued ASC 805, *Business Combinations* (ASC 805). ASC 805 revises accounting and reporting standards for business combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses by transferring consideration as well as combinations achieved without the transfer of consideration. By applying the same method of accounting—the acquisition method—to all transactions and other events in which one entity obtains control over one or more other businesses, this statement is intended to improve the comparability of the information about business combinations provided in financial reports. ASC 805 applies prospectively to business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently in the process of evaluating ASC 805, and has not yet determined the impact, if any, that accounting for future business combinations under ASC 805, effective January 1, 2009, will have on its consolidated results of operations or financial position.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05 (ASC Update 2009-05), an update to FASB ASC 820, *Fair Value Measurements and Disclosures*. This update provides amendments to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. Among other provisions, this update provides clarification that in circumstances, in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the valuation techniques described in ASC Update 2009-05. ASC Update 2009-05 will become effective for the Company's annual financial statements for the year ended December 31, 2009. The Company has not determined the impact that this update may have on its financial statements.

In June 2009, the FASB issued FAS No. 166, *Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140*. This pronouncement has not yet been incorporated into the FASB's codification. This standard will require more information about transferred financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a Company's first fiscal year beginning after November 15, 2009, or January 1, 2010, for companies reporting earnings on a calendar-year basis. The Company is currently analyzing the impact of this statement, if any, to its condensed financial statements.

In May 2009, the FASB issued an accounting standard codified within ASC 855, *Subsequent Events*, (ASC 855 and formerly referred to as SFAS No. 165), which modified the subsequent event guidance. The three modifications to the subsequent events guidance are: 1) To name the two types of subsequent events either as recognized or non-recognized subsequent events, 2) To modify the definition of subsequent events to refer to events or transactions that occur after the balance sheet date, but before the financial statement are issued or available to be issued and 3) To require entities to disclose the date through which an entity has evaluated subsequent events and the basis for that date, i.e. whether that date represents the date the financial statements were issued or were available to be issued. This guidance is effective for interim or annual financial periods ending after June 15, 2009, and should be applied prospectively. The Company adopted ASC 855 during the quarter ended June 30, 2009 and it did not have a material impact on the Company's condensed financial statements.

In April 2009, the FASB issued an accounting standard codified within ASC 825, *Financial Instruments*, (ASC 825), ASC 825-10-65, *Transition and Open Effective Date Information*, (ASC 825-10-65 and formerly referred to as FSP FAS No. 107-1 and APB Opinion No. 28-1), which requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. This guidance also requires those disclosures in summarized financial information at interim reporting periods. ASC 825-10-65 is effective prospectively for interim reporting periods ending after June 15, 2009. The Company adopted ASC 825 in the quarter ended June 30, 2009. The adoption of ASC 825 did not have a material impact on the Company's condensed financial statements.

In April 2009, the FASB issued an accounting standard codified within ASC 820, *Fair Value Measurements and Disclosures*, (ASC 820 and formerly referred to as FSP FAS 157-4), ASC 820 affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. ASC 820 is effective for interim and annual periods ending after June 15, 2009. The Company adopted ASC 820 in the quarter ended June 30, 2009. The adoption did not have a material impact on the Company's condensed financial statements.

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)****4. LINE OF CREDIT**

The Company has two significant lines of credit for its European operations. The first credit facility amounting to \$730 thousand is with Svenska Handelsbanken AB with interest charged at Handelsbanken Avista +0.9%, which at September 30, 2009 was approximately 1.8%. The second significant line of credit amounting to \$438 thousand is with Okopankki Oyj with interest charged at 1 month euribor +1.0%, which at September 30, 2009 was approximately 3.5%. \$701 thousand of the combined facility was outstanding as of September 30, 2009. Commitments by the banks generally expire one year from the date of the agreement and are generally renewed.

5. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares plus the dilutive effect of outstanding stock options under our equity incentive plans. Stock options outstanding not included in the table below because of their anti-dilutive effect for the three and nine months ended September 30, 2009 were 755,000.

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:

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Net loss	\$ (1,000,651)	\$ (3,881,352)	\$ (3,140,542)	\$ (7,334,183)
Weighted average number of common shares outstanding used in computing basic earnings per share	20,532,883	20,603,140	20,532,883	20,603,140
Dilutive effect of stock options outstanding				
Weighted average shares used in computing diluted earnings per share	20,532,883	20,603,140	20,532,883	20,603,140
Basic earnings (loss) per share	\$ (0.05)	\$ (0.19)	\$ (0.15)	\$ (0.36)
Diluted earnings (loss) per share	\$ (0.05)	\$ (0.19)	\$ (0.15)	\$ (0.36)

6. COMPREHENSIVE INCOME

A reconciliation of comprehensive loss is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Net loss	\$ (1,000,651)	\$ (3,881,352)	\$ (3,140,542)	\$ (7,334,183)
Foreign currency translation adjustment	(1,131,037)	2,641,315	(411,395)	2,826,785

Comprehensive loss	\$ (2,131,688)	\$ (1,240,037)	\$ (3,551,937)	\$ (4,507,398)
--------------------	----------------	----------------	----------------	----------------

7. SEGMENT INFORMATION

The Company operates predominantly in the clinical research industry providing a broad range of clinical research services on a global basis to the pharmaceutical, biotechnology and medical device industries.

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009		2008		2009		2008	
	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts	Percentage of Revenues	Number of Contracts
Client A	31%	13	9%	2	33%	13	11%	2
Client B	17%	4	10%	2	8%	13	10%	2
Client C	7%	13	7%	13	7%	4	8%	13
Top Clients	55%	30	26%	17	48%	30	29%	17

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

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)**

The following table summarizes the distribution of net revenues from external clients by geographical region for the three and nine months ended September 30, 2009 and 2008.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Finland	\$ 2,439,947	\$ 3,141,591	\$ 7,800,486	\$ 10,056,848
Rest of Europe	2,006,659	2,255,303	5,667,556	6,660,116
Total	\$ 4,446,606	\$ 5,396,894	\$ 13,468,042	\$ 16,716,964

The following table summarizes the distribution of the Company's long lived assets by geographical region as of September 30, 2009 and December 31, 2008.

	September 30, 2009	December 31, 2008
U.S.	\$ 0	\$ 881,666
Europe	5,331,882	5,430,049
Total	\$ 5,331,882	\$ 6,311,715

8. STOCKHOLDERS EQUITY***Treasury Stock***

In October 2008 the Company approved a stock repurchase program in an amount of up to \$250,000. During the three months ended December 31, 2008, the Company purchased 79,257 shares of Common Stock at an average price of \$0.36 per share in open market transactions. There were 310,121 common shares in treasury as of December 31, 2008. The shares are valued using the cost method of accounting for treasury stock. The Company did not make any purchases of Common Stock during the nine months ended September 30, 2009.

Share-Based Compensation

Effective January 1, 2006 we adopted ASC 718 using the Modified Prospective Approach. ASC 718 requires the cost of all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values at grant date, or the date of later modification, over the requisite service period.

Under the Modified Prospective Approach, the amount of compensation expense recognized includes compensation expense for all share-based payments granted prior to, but not yet fully vested as of January 1, 2006, based on the grant date fair value estimated in accordance with ASC 718 and compensation expense for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with ASC 718.

For the three months and nine months ended September 30, 2009, ASC 718 resulted in incremental stock-based compensation expense of \$221 thousand and \$300 thousand, respectively, or \$0.01 and \$0.01 on a basic and diluted earning per share basis. For the three and nine months

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

ended September 30, 2008, ASC 718 resulted in incremental stock-based compensation expense of \$52 thousand and \$186 thousand, respectively, or \$0.01 and \$0.01 on a basic and diluted earning per share basis. The compensation expense associated with ASC 718 did not have a net impact on cash flows from operating, investing or financing activities. A deduction is not allowed for income tax purposes until the options are exercised. The amount of the income tax deduction will be the difference between the fair value of the Company's common stock and the exercise price at the date of exercise. The tax effect of the income tax deduction in excess of the financial statement expense will be recorded as an increase in additional paid-in-capital. Accordingly, ASC 718 requires the recognition of a deferred tax asset for the tax effect of the financial statement expense recorded. However, due to our recent loss history, and uncertainty regarding the realization of deferred tax assets, deferred tax assets have been fully reserved as of September 30, 2009. The net operating losses incurred to date by the Company are being carried forward and may be applied against future taxable income subject to certain limitations set forth in Section 382 of the Internal Revenue Code.

The Company has issued stock options to employees under share-based compensation plans. Stock options issued prior to January 1, 2007 were issued at the current market price on the date of the grant, subject to a 3 year vesting period with a contractual term of 5 years. Stock options issued after January 1, 2007 were issued at the current market price on the date of grant, subject to a 3 year vesting period with a contractual term of 10 years. The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of our common stock. We use historical data on exercises of stock options and other factors to estimate the expected life of the share-based payments granted. For options granted prior to January 1, 2006, we determined the expected life to be 5 years, and an expected life of 4 years for any options granted between January 1, 2006 and December 31, 2006. For options issued subsequent to January 1, 2007, we determined the expected life to be 7 years due to the adoption of a new stock option plan under which these shares were issued. The risk free rate is based on the U.S. Treasury bond rate commensurate with the expected life of the option.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Risk-free interest rate	3.12% - 3.26%		2.20% - 2.55%	
Expected dividend yield				
Expected life	7 years		7 years	7 years
Expected volatility	65.20%		72.50%	63.17%
Forfeiture rate	15.00%		15.00%	15.00%

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)**

A summary of award activity under the stock option plans as of September 30, 2009 and changes during the nine month period is presented below:

	Number of Shares	Range of Exercise Prices per Share	Weighted Average Exercise Price per Share	Intrinsic Value
Options outstanding at December 31, 2008	954,083	\$0.24 - 6.08	\$ 2.29	(1,564,696)
Granted	102,750	.19 - .29	0.29	36,990
Exercised				
Canceled	(23,417)	2.50 - 2.60	2.52	43,821
Options outstanding at March 31, 2009	1,033,416	\$0.19 - 6.08	\$ 0.91	(268,688)
Granted				
Exercised				
Canceled	(253,416)	.19 - 4.10	1.27	157,118
Options outstanding at June 30, 2009	780,000	\$0.24 - 6.08	\$ 0.79	(109,200)
Granted				
Exercised				
Canceled	(25,000)	2.25	2.25	40,000
Options outstanding at September 30, 2009	755,000	\$0.24 - 6.08	\$ 0.74	(67,950)
Vested options outstanding at:				
September 30, 2009	371,665	\$0.24 - 6.08	\$ 0.83	\$ (66,900)
Non-vested options outstanding at:				
September 30, 2009	383,335	\$0.24 - 6.08	\$ 0.65	\$ 0

Approximately 121,834 options, net of forfeitures, of the 383,335 non-vested options as of September 30, 2009 will vest within the next year.

As of September 30, 2009, there was approximately \$65 thousand of total unrecognized compensation cost related to unvested share-based compensation awards granted under the stock option plans. That cost is expected to be recognized over a weighted-average period of approximately 1.6 years.

Based upon the above assumptions, the weighted average fair value of the stock options granted for the three months ended September 30, 2009 and 2008 was \$0 and \$1.05, respectively. There were no options granted for the three months ended September 30, 2009. The weighted average fair value of the stock options granted for the nine months ended September 30, 2009 and 2008 was \$0.20 and \$1.04, respectively.

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

The following table summarizes information regarding stock options outstanding at September 30, 2009:

Options Outstanding

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Range of Exercise Prices	Number Outstanding at September 30, 2009	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price per Share
\$0.01-\$0.50	655,000	9.11	\$ 0.30
\$1.51-\$2.00	45,000	8.55	1.77
2.51-3.00	15,000	8.12	2.67
\$6.00 - \$6.50	40,000	7.32	6.08
	755,000	8.96	\$ 0.74

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)**

The following table summarizes information regarding exercisable stock options at September 30, 2009:

Range of Exercise Prices	Options Exercisable		Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price Per Share
	Number of Exercisable Options at September 30, 2009			
\$0.01-\$0.50	325,000		9.00	\$ 0.33
1.51-2.00	14,999		8.55	1.77
2.51-3.00	5,000		8.12	2.67
\$6.00 - \$6.50	26,666		7.32	6.08
	371,665		8.85	\$ 0.83

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

Range of Exercise Prices	Options Expected To Vest		Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price Per Share
	Options Expected to Vest Net of Forfeitures			
\$0.01-\$0.50	93,501		9.22	0.27
\$1.51-\$2.00	12,749		8.55	1.77
2.51-3.00	4,250		8.12	2.67
\$6.00 - \$6.50	11,334		7.32	6.08
	121,834		8.93	1.05

9. SUPPLEMENTAL CASH FLOW INFORMATION

No income tax payments were required for the nine months ended September 30, 2009 and 2008, respectively. Cash paid for interest for the nine months ended September 30, 2009 and 2008 was approximately \$31 thousand and \$19 thousand, respectively. We did not enter into any capital lease obligations during the nine months ended September 30, 2009 and 2008. We did not acquire any property and equipment through leasing arrangements during the nine months ended September 30, 2009 or 2008, respectively.

10. GOODWILL AND OTHER INTANGIBLES

The amount of Goodwill resulting from the Encorium Oy (formerly Remedium) acquisition, including deferred taxes of \$1,697,724, was \$15,388,299 which was determined as the excess of cost over the fair values of acquired net assets and as such was not amortized.

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)**

Goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If carrying value exceeds current fair value, then goodwill is considered impaired and is reduced to fair value via a charge to earnings. The Company performed its annual impairment testing as of November 1, 2008. The fair value of the reporting unit was estimated using the expected present value of future cash flows and market values of comparable companies using estimates, judgments and assumptions that Management believes were appropriate in the circumstances. The sum of the fair value was reconciled to the Company's current market capitalization. As a result of this reconciliation process the Company recorded an impairment charge related to goodwill of \$12.5 million in the fourth quarter of 2008. The Company will perform its next annual impairment testing as of November 1, 2009.

The Company also acquired \$6.5 million of identifiable intangible assets in connection with the Encorium Oy acquisition. Of the \$6.5 million of acquired intangible assets, \$3.9 million was attributed to customer relationships, \$2.6 million was attributable to backlog and \$53 thousand was attributable to a non-compete agreement. All of these intangibles are subject to amortization on a straight-line basis. The estimated useful lives for customer relationships, backlog and non-compete agreement are 16 years, 18 months and 4 years, respectively. Amortization expense for the three months ended September 30, 2009 and 2008 was \$72 thousand and \$374 thousand, respectively. Amortization expense for the nine months ended September 30, 2009 and 2008 was \$205 thousand and \$1.1 million, respectively. The estimated amortization of intangibles expense to be recorded in future periods is as follows:

2009	\$ 72,965
2010	289,312
2011	276,579
2012	276,579
2013	276,579

11. INCOME TAXES

The Company accounts for income taxes in accordance with the provisions of FASB ASC 740, *Accounting for Income Taxes* (ASC 740). ASC 740 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 September 30, 2009, 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.

The Company files its tax returns as prescribed by the tax laws of the jurisdiction in which it operates. The Company's policy is to recognize interest and penalties in Other Expense.

12. COMMON STOCK AND WARRANTS

In May 2007, the Company sold 1,748,252 shares of its common stock, \$0.001 par value in a private placement (the Offering) at a price of \$2.86 per share and warrants to purchase an aggregate of 874,126 shares of the Company's common stock, \$0.001 par value, at an exercise price of \$4.12 per share for a period of five years commencing nine months from the date of issuance. The Offering resulted in aggregate gross proceeds to the Company of \$5 million before deducting commissions, fees and expenses.

13. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the issuance of these consolidated condensed financial statements on November 16, 2009.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

On October 19, 2009, the Company sold 3,937,500 shares of its common stock, \$0.001 par value in a private placement (the Stock Sale) at a price of \$0.40 per share to a private investor.

Prior to the Stock Sale, the Company entered into Warrant Exchange Agreements with two investors (the Investors) pursuant to which the Company issued to the Investors an aggregate of 1,864,000 shares of Common Stock (collectively, the Exchange Shares) and warrants to purchase an aggregate of 874,126 shares of Common Stock, exercisable for a period of five years, at an exercise price of \$.40 per share (collectively, the Exchange Warrants). The Exchange Shares and Exchange Warrants were issued in exchange for warrants dated as of May 9, 2007 (see note 12 above) held by the Investors to purchase an aggregate of 874,126 shares of Common Stock of the Company (collectively, the Original Warrants).

Table of Contents**ENCORIUM GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)****14. DISCONTINUED OPERATIONS**

On July 17, 2009, the Company sold its U.S. business to Pierrel Research USA, Inc., a wholly-owned subsidiary of Pierrel SpA, an international contract research organization listed on Milan's Stock Exchange. The purchase price of \$2.7 million consisted of cash of \$80 thousand and the assumption of \$2.6 million of liabilities. As a result of the sale, the results of the U.S. business are included in discontinued operations in the Company's consolidated statements of operations. In addition, any assets and liabilities related to these discontinued operations are presented separately on the consolidated balance sheets and any cash flows related to these discontinued operations are presented separately in the consolidated statements of cash flows. All prior period information has been reclassified to be consistent with the current period presentation. The following amounts related to the U.S. Business were derived from historical financial information and have been segregated from continued operations and reported as discontinued operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net revenue	\$ 20,320	\$ 2,041,106	\$ 3,823,332	\$ 6,467,120
Reimbursement revenue		358,664	891,818	877,486
Total Revenue	20,320	2,399,770	4,715,150	7,344,606
Operating Expenses				
Direct	2,802	1,859,052	2,484,567	5,548,941
Reimbursement out-of-pocket expenses		358,664	891,818	877,486
Selling, general and administrative	1,048,747	1,566,211	2,363,795	3,964,916
Depreciation and amortization		102,256	199,865	311,208
Total Operating Expenses	1,051,549	3,886,183	5,940,045	10,702,551
Loss from Operations	(1,031,229)	(1,486,413)	(1,224,895)	(3,357,945)
Interest Income	25	16,438	3,402	87,271
Interest Expense	0	(2,257)	(3,918)	(7,117)
Net Interest (Expense) Income	25	14,181	(516)	80,154
Gain on sale of assets	772,768		772,768	
Other expense			(101,373)	
Net Loss before Income Taxes	(258,436)	(1,472,232)	(554,016)	(3,277,791)
Income Tax Benefit		(16,590)		(200,356)

Net Loss	\$ (258,436)	\$ (1,455,642)	\$ (554,016)	\$ (3,077,435)
-----------------	--------------	----------------	--------------	----------------

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Forward Looking Statements

When used in this Report on Form 10-Q 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) the risk that we may not have sufficient funds to operate our business; (ii) our success in attracting new business and retaining existing clients and projects; (iii) the size, duration and timing of clinical trials we are currently managing may change unexpectedly; (iv) the termination, delay or cancellation of clinical trials we are currently managing could cause revenues and cash-on-hand to decline unexpectedly; (v) the timing difference between our receipt of contract milestone or scheduled payments and our incurring costs to manage these trials; (vi) outsourcing trends in the pharmaceutical, biotechnology and medical device industries; (vii) the ability to maintain profit margins in a competitive marketplace; (viii) our ability to attract and retain qualified personnel; (ix) the sensitivity of our business to general economic conditions; (x) other economic, competitive, governmental and technological factors affecting our operations, markets, products, services and prices; (xi) announced awards received from existing and potential customers are not definitive until fully negotiated contracts are executed by the parties; (xii) our backlog may not be indicative of future results and may not generate the revenues expected; and (xiii) uncertainties regarding the availability of additional capital and continued listing of our common stock on Nasdaq. You should not place undue reliance on any forward-looking statement. 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 beginning on page 20 in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 for a more complete discussion of factors which could cause our actual results and financial position to change.

Overview

We are a clinical research organization that engages in the design and management of complex clinical trials for the pharmaceutical, biotechnology and medical device industries. We were initially incorporated in August 1998 in Nevada. In June 2002, we changed our state of incorporation to Delaware. In November 2006, we expanded our international operations with the acquisition of our wholly-owned subsidiary, Encorium Oy, a CRO founded in 1996 in Finland, which offers clinical trial services to the pharmaceutical and medical device industries. Since 2006 we have conducted substantially all of our European operations through Encorium Oy and its wholly-owned subsidiaries located in Denmark, Estonia, Sweden, Lithuania, Romania, Germany and Poland. On July 16, 2009 the Company sold substantially all of the assets relating to the Company's US line of business to Pierrel Research USA, Inc., the result of which the Company no longer has any employees or significant operations in the United States. Due to this sale, for the nine months ended September 30, 2009 and 2008, the results of the U.S. business have been presented as discontinued operations in the consolidated financial statements.

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

On October 19, 2009, we announced that we had completed a private placement of 3,937,500 shares of our common stock with a private investor for an aggregate purchase price of \$1,575,000 or \$0.40 per share.

Prior to the transaction, the Company entered into Warrant Exchange Agreements with two investors (the Investors) pursuant to which the Company issued to the Investors an aggregate of 1,864,000 shares of Common Stock (collectively, the Exchange Shares) and warrants to purchase an aggregate of 874,126 shares of Common Stock, exercisable for a period of five years, at an exercise price of \$0.40 per share (collectively, the Exchange Warrants). The Exchange Shares and Exchange Warrants were issued in exchange for

Table of Contents

warrants dated as of May 9, 2007 held by the Investors to purchase an aggregate of 874,126 shares of Common Stock of the Company (collectively, the Original Warrants). Except as described above, the terms of the Exchange Warrants, including anti-dilution adjustments, are substantially similar to those of the Original Warrants.

The Company also announced on October 19, 2009, that it has terminated previously announced negotiations for the sale of the Company's wholly-owned subsidiary Encorium OY to a clinical research organization based in the United States and will not pursue a sale of the Company or Encorium Oy at this time.

Historically our net cash used in operations has been substantial. Our net cash used in operations for the nine months ended September 30, 2009 was \$5.4 million. Our cash and cash equivalents as of September 30, 2009 was \$318 thousand. We anticipate that will meet our cash requirements at least into the second quarter of 2010, assuming we are able to fully implement our current costs cutting initiatives, we are able to win additional contracts during fiscal 2009 and we are able to maintain our current customer contracts. We will continue to seek strategic alternatives, including, but not limited to attempting to secure additional financing. Our ability to obtain additional financing in the future will depend in part upon prevailing capital market conditions, as well as conditions in our business and our operating results; and those factors may affect our efforts to arrange additional financing on terms that are satisfactory to us or at all. If we are unable to secure additional financing on terms acceptable to us and on a timely basis, we may significantly reduce our operating costs, which may include the cessation of operations in some countries. Our consolidated financial statements do not include any adjustment to reflect the possible future effects on the recoverability or classification of assets or the amounts and classification of liabilities that may result from the outcome of our ability to continue as a going concern.

The accompanying consolidated financial statements have been prepared on the basis of the Company continuing as a going concern. However, the factors summarized above have raised substantial doubt about our ability to continue as a going concern for the foreseeable future.

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. A significant portion 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.

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, 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. 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.

General

The information set forth and discussed below for the nine months ended September 30, 2009 and 2008 is derived from the Consolidated Condensed Financial Statements included elsewhere herein. The financial information set forth and discussed below is unaudited but, in the opinion of management, reflects all adjustments (primarily consisting of normal recurring adjustments) necessary for a fair presentation of such information. The results of our operations for a particular quarter may not be indicative of results expected during the other quarters or for the entire year.

Our quarterly results can fluctuate as a result of a number of factors, including our success in attracting new business, the size and duration of clinical trials, the timing of client decisions to conduct new clinical trials or to cancel or delay ongoing trials, changes in cost estimates to complete ongoing trials, and other factors, many of which are beyond our control.

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. A significant portion 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. Total direct costs are incurred for each contract and compared to estimated total direct costs for each

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

contract to determine the percentage of the contract that is completed. This percentage is multiplied by the estimated total contract value to determine the amount of net revenue recognized.

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 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.

Our backlog relative to continuing operations was approximately \$19.9 million as of September 30, 2009 as compared to \$27.0 million as of September 30, 2008. Our backlog consists of anticipated net revenue from signed contracts and letters of intent that either have not started but are anticipated to begin in the near future or are in process and have not yet been completed. 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 and contract terminations, if any, reduces our backlog while the awarding of new business increases our backlog. For the nine months ended September 30, 2009 we obtained approximately \$8.3 million of new business awards as compared to approximately \$17.4 million for the nine months ended September 30, 2008.

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 relating to our clinical trial business 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.

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.

Table of Contents

Percentage of net revenue, excluding reimbursable out-of-pocket expenses:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net revenue	100.0%	100.0%	100.0%	100.0%
Operating Expenses				
Direct	65.4%	65.2%	68.8%	66.0%
Selling, general and administrative	46.2%	37.7%	47.4%	40.9%
Depreciation	2.2%	7.5%	2.1%	7.1%
Loss from Operations	(13.9)%	(44.8)%	(18.3)%	(25.0)%
Net Loss from continuing operations	(16.7)%	(44.9)%	(19.2)%	(25.5)%

Contractual Obligations and Commitments

We did not enter into any capital lease obligations during the three months ended September 30, 2009 and 2008. We are committed under a number of non-cancelable operating leases, primarily related to office space and other office equipment.

In June 2008, the Company decreased by approximately 10,774 to 23,252 the amount of square feet under the lease agreement for its corporate office located in Wayne, Pennsylvania. The term of the lease was also extended to December 31, 2014 from November 30, 2009 and the monthly lease payments were reduced from approximately \$79 thousand to approximately \$53 thousand. Under the terms of the agreement, the Company was required to establish an irrevocable letter of credit in the amount \$170,000 as a security deposit. The amount of the letter of credit is reduced by approximately \$28,333 each year beginning on June 1, 2009 until reduced to \$0 on December 31, 2014. The letter of credit was obtained in June 2008 and is included in Other Assets. In connection with the consummation of the sale of the U.S. business on July 16, 2009, the Company entered into an amendment of the lease for its corporate headquarters pursuant to which the Company was released from its remaining obligations under the lease for a termination fee equal to \$235,000, the waiver of any rights to the Company's security deposit of approximately \$20,000 and payment of any outstanding lease obligations through July 31, 2009. The remaining \$142,000 of the Letter of Credit as of July 16, 2009, the closing date of the U.S. transaction, was used to satisfy a portion of the termination fee.

Below is a summary of our future payment commitments by year under contractual obligations. 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:

	2009	2010	2011	Thereafter	Total
Obligations under capital leases	\$ 13,609	\$ 54,436	\$ 54,436	\$	\$ 122,481
Operating leases	655,532	1,429,600	997,784	1,232,412	4,315,328
Employment agreement	451,667				451,667
Service agreements	42,500				42,500
	\$ 1,163,308	\$ 1,484,036	\$ 1,052,220	\$ 1,232,412	\$ 4,931,976

In 2009, we anticipate capital expenditures of approximately \$100,000 \$200,000 for leasehold improvements, software applications, workstations, personal computer equipment and related assets.

Critical Accounting Policies and Estimates

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

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

A significant portion 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 collectability 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.

There are no standard billing and payment provisions which are present in each contract. Each contract has separate and distinct billing and payment terms which are the result of negotiation between us and the client. 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. The payment schedule in the contract reflects the value of services to be performed by us at the initiation of the contract. The payment schedule may include the value of certain interim service components as well as periodic payments which are reasonably assured at the start of the contract and which we expect to receive during the duration of the contract. Accordingly, cash receipts, including the receipt of up front payments, periodic payments and payments related to the achievement of certain billing mechanisms, do not necessarily correspond to cost incurred and revenue recognized on contracts. A contract's payment structure typically requires an upfront payment of 10% to 20% of the contract value at or shortly after the initiation of the contract, a series of periodic payments over the life of the contract and payments based upon the achievement of certain billing mechanisms. The

Table of Contents

upfront payments are deferred and recognized as revenues and services are performed under the proportional performance method. Periodic payments, including payments related to the achievement of certain billing mechanisms in the contract, are invoiced pursuant to the terms of the contract once the agreed upon services criteria have been achieved. Payments based upon interim billing mechanisms are included in the value of the contract because we expect to receive them during the term 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 service components separately but as an integrated, full service arrangement in connection with the development of the drug.

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

Our accounting policy for recognizing revenue for terminated projects requires us to perform a reconciliation of study activities versus the activities set forth in the contract. We negotiate with the client, pursuant to the terms of the existing contract, regarding the wind up of existing study activities in order to clarify which services the client wants us to perform. Once we and the client agree on the reconciliation of study activities and the agreed upon services have been performed by us, we would record the additional revenue provided collectability 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. 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 will continue to exclude from revenue and expense in the Consolidated Statements of Operations fees paid to investigators and the associated reimbursement since we act as an agent on behalf of the pharmaceutical company sponsors with regard to investigator payments. These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of investigator fees for the three months ended September 30, 2009 and 2008 were \$54 thousand and \$1.2 million, respectively. The amounts of investigator fees for the nine months ended September 30, 2009 and 2008 were \$1.0 million and \$4.5 million, respectively

Stock-Based Compensation

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

Effective January 1, 2006, we adopted ASC 718 which requires the costs for all share-based payments to employees, including grants of employee stock options, to be recognized in financial statements based on their fair values at grant date, or the date of later modification, over the requisite period. In addition, ASC 718 requires unrecognized cost (based on the amounts previously disclosed in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized in the financial statements over the remaining requisite period.

The grant date fair value of each stock option is based on the underlying price on the date of grant and is determined using an option pricing model. The option pricing model requires the use of estimates and assumptions as to (a) the expected volatility of the price of underlying stock option (b) the expected life of the option and (c) the risk free rate for the expected life of the option. The Company is currently using the Black-Scholes option pricing model to determine the grant date fair value of each stock option.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Expected volatility is based on historical volatility of our common stock. We use historical data on exercises of stock options and other factors to estimate the expected life of the share-based payments granted. For the options granted prior to January 1, 2006, we determined the expected life to be 5 years, and an expected life of 4 years for any options granted between January 1, 2006 and December 31, 2006. For options granted subsequent to January 1, 2007 we determined the expected life to be 7 years due to the adoption of a new stock option plan under which these shares were issued. The risk free rate is based on the U.S. Treasury bond rate commensurate with the expected life of the option. Forfeiture rates are estimated based upon past voluntary termination behavior and past option forfeitures.

The estimated annual share-based compensation expense relating to ASC 718 for the twelve months ended December 31, 2009 is expected to be \$317 thousand. The Company recognized stock-based compensation expense of \$221 thousand, or \$0.01 on a basic and diluted earning per share basis, for the three months ended September 30, 2009 and \$300 thousand or \$0.01 on a basic and diluted earning per share basis for the nine months ended September 30, 2009. The Company recognized stock-based compensation expense of \$52 thousand for the three months ended September 30, 2008, or \$0.01 on a basic and diluted earning per share basis and \$186 thousand for the nine months ended September 30, 2008.

Goodwill and Intangible Assets

The Company follows the provisions of ASC 805, *Business Combinations*, and ASC 350, *Goodwill and Other Intangible Assets*, applicable to business combinations. In accordance with these standards, goodwill acquired in connection with the acquisition of Encorium Oy (formerly Remedium) was not amortized. However, the identifiable intangible assets acquired in connection with the acquisition of Encorium Oy are being amortized over their useful lives. Under ASC 350, goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If carrying value exceeds current fair value, then goodwill is considered impaired and is reduced to fair value via a charge to earnings. The identifiable intangibles acquired in connection with the acquisition of Encorium Oy are also subject to impairment testing under ASC 350, whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. The Company performed its annual impairment testing as of November 1, 2008. The fair value of the reporting unit was estimated using the expected present value of future cash flows and market values of comparable companies using estimates, judgments and assumptions that Management believes were appropriate in the circumstances. The sum of the fair value was reconciled to the Company's current market capitalization. As a result of this reconciliation process the Company recorded an impairment charge related to goodwill of \$12.5 million in the fourth quarter of 2008. The Company will perform its next annual impairment testing as of November 1, 2009.

Table of Contents

Foreign Currency Translation

The functional currency of the Company is the U.S. dollar. The functional currency of the Company's foreign operations generally is the applicable local currency for each foreign subsidiary. Assets and liabilities of foreign subsidiaries are translated at the spot rate in effect for the reporting date, and consolidated statements of operations are translated at the average exchange rates in effect during the applicable period. The resulting unrealized cumulative translation adjustment, net of applicable income taxes, is recorded as a component of accumulated other comprehensive income in stockholder's equity.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses which are reflected in the accompanying consolidated condensed statements of operations as unrealized (based on the applicable period exchange rate) or realized upon settlement of the transactions.

Results of Operations

Three Months Ended September 30, 2009 Compared With Three Months Ended September 30, 2008

Continuing Operations:

Net revenue for the three months ended September 30, 2009 decreased by \$1.0 million to \$4.4 million as compared to \$5.4 million for the three months ended September 30, 2008. The decrease in net revenues was primarily attributable to unfavorable foreign currency fluctuations of \$200 thousand for the three months ended September 30, 2009 compared with the same prior year period. Approximately \$650 thousand was attributable to revenue recognized on a contract that completed in 2008. For the three months ended September 30, 2009, net revenue from our largest clients amounted to 55% of our net revenue, with the largest clients representing 31%, 17% and 7% of net revenue, respectively. For the three months ended September 30, 2008, net revenue from our largest clients amounted to 26% of our net revenue, with the largest clients representing 9%, 10% and 7% of net revenue, respectively.

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 approximately \$600 thousand to \$2.9 million for the three months ended September 30, 2009 from \$3.5 million for the three months ended September 30, 2008. The decrease in direct expenses was due to favorable foreign currency fluctuations of approximately \$156 thousand combined with reductions in staff and subcontractors utilized on active clinical studies being conducted net of severance and other costs during the three months ended September 30, 2009 compared to same prior year period. Direct expenses as a percentage of net revenue were approximately 65% for the three months ended September 30, 2009 and September 30, 2008.

Selling, general, and administrative expenses (SG&A) includes the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. These costs were approximately \$2.1 million for the three months ended September 30, 2009 and September 30, 2008. As a percentage of revenues, SG&A expenses increased by 8% to 46% for the three months ended September 30, 2009 compared with 38% the prior year period.

Depreciation and amortization expense decreased by \$305 thousand to \$99 thousand for the three months ended September 30, 2009 from \$404 thousand for the three months ended September 30, 2008, primarily as a result of certain intangible assets acquired as part of the Encorium Oy acquisition being fully amortized.

During the three months ended September 30, 2008, the Company took a non-cash impairment charge of \$1.86 million in connection with its analysis of the carrying value of goodwill acquired in connection with the acquisition of Encorium Oy.

Loss from operations decreased by \$1.8 million to \$600 thousand for the three months ended September 30, 2009 compared to loss from operations of \$2.4 million from operations for the three months ended September 30, 2008, primarily for the reasons noted in the preceding paragraphs.

Net interest expense for the three months ended September 30, 2009 was \$27 thousand compared to net interest expense of \$16 thousand for the three months ended September 30, 2008. This decrease was due to a reduction in the amount of cash on hand during the three months ended September 30, 2009 compared to the same prior year period.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Net loss from continuing operations for the three months ended September 30, 2009 was \$742 thousand, or \$(0.04) per diluted share, as compared to a net loss from continuing operations of \$2.4 million, or \$(0.12) per diluted share for the three months ended September 30, 2008.

Discontinued Operations, Net of Tax

The net after tax loss from discontinued operations for the three months ended September 30, 2009 amounted to \$258 thousand as compared to the net after tax loss of \$1.5 million from discontinued continued operations during the three months ended September 30, 2008.

Nine Months Ended September 30, 2009 Compared With Nine Months Ended September 30, 2008

Continuing Operations:

Net revenue for the nine months ended September 30, 2009 decreased by \$3.2 million to \$13.5 million as compared to \$16.7 million for the nine months ended September 30, 2008. The decrease in net revenues was primarily due to unfavorable foreign currency fluctuations of approximately \$1.4 million for the nine months ended September 30, 2009 compared with the same prior year period. Approximately \$2.2 million was attributable to revenue recognized on a contract that was completed during 2008, another \$500 thousand was attributable to lower volume of contracts within our European operations. For the nine months ended September 30, 2009, net revenue from our largest clients amounted to 48% of our net revenue, with the largest clients representing 33%, 8% and 7% of net revenue, respectively. For the nine months ended September 30, 2008, net revenue from our largest clients amounted to 29% of our net revenue, with the largest clients representing 11%, 10% and 8% of net revenue, respectively.

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 approximately \$1.7 million to \$9.3 million for the nine months ended September 30, 2009 from \$11.0 million for the nine months

Table of Contents

ended September 30, 2008. The decrease in direct expenses was primarily due to favorable foreign currency fluctuations of \$1.1 thousand for the nine months ended September 30, 2009 compared with the same prior year period. In addition, direct expenses decreased as a result of reductions in staff and subcontractors utilized on active clinical studies being conducted net of severance and other costs during the nine months ended September 30, 2009 compared to same prior year period. Direct expenses as a percentage of net revenue increased by 2.8% to 68.8% for the nine months ended September 30, 2009 as compared to 66.0% for the nine months ended September 30, 2008, primarily due to reduced margins associated with the contract that completed in 2008 coupled with the severance and other costs incurred during the nine months ended September 30, 2009 as compared with the same period during 2008.

Selling, general, and administrative expenses (SG&A) includes the salaries, wages and benefits of all administrative, financial and business development personnel and all other support expenses not directly related to specific contracts. These costs decreased by approximately \$400 thousand to \$6.4 million for the nine months ended September 30, 2009 from \$6.8 million for the nine months ended September 30, 2008. The decrease in SG&A was due primarily to favorable foreign currency fluctuations of \$580 thousand, staff reductions and reductions in overhead cost of approximately \$200 thousand partially offset by increased professional fees associated with the sale of the U.S. Business. As a percentage of revenues, SG&A expenses increased by 6.5% to 47.4% for the nine months ended September 30, 2009 compared with 40.9% the prior year period.

Depreciation and amortization expense decreased by approximately \$900 thousand to \$282 thousand for the nine months ended September 30, 2009 from \$1.18 million for the nine months ended September 30, 2008, primarily as a result of certain intangible assets acquired as part of the Encorium Oy acquisition being fully amortized.

During the nine months ended September 30, 2008, the Company took a non-cash impairment charge of \$1.86 million in connection with its analysis of the carrying value of goodwill acquired in connection with the acquisition of Encorium Oy.

Loss from operations decreased by \$1.8 million to \$2.4 million for the nine months ended September 30, 2009 compared to loss from operations of \$4.2 million from operations for the nine months ended September 30, 2008, primarily for the reasons noted in the preceding paragraphs.

Net interest expense for the nine months ended September 30, 2009 was \$31 thousand compared to net interest expense of \$10 thousand for the nine months ended September 30, 2008. This decrease was due to a reduction in the amount of cash on hand during the nine months ended September 30, 2009 compared to the same prior year period.

The income tax expense of \$91 thousand for the nine months ended September 30, 2009 was principally related to provisions within our European group of companies.

Net loss for from continuing operations the nine months ended September 30, 2009 was \$2.6 million thousand, or \$(0.13) per diluted share, as compared to a net loss of \$4.3 million, or \$(0.21) per diluted share for the nine months ended September 30, 2008.

Discontinued Operations, Net of Tax

The net after tax loss from discontinued operations for the nine months ended September 30, 2009 amounted to \$554 thousand as compared to the net after tax loss of \$3.1 million from discontinued continued operations during the nine months ended September 30, 2008.

Liquidity and Capital Resources

On July 16, 2009, the Company sold substantially all of the assets relating to the Company's US line of business to Pierrel Research USA, Inc., the result of which the Company no longer has any employees or significant operations in the United States. Due to this sale, for the nine months ended September 30, 2009 and 2008, the results of the U.S. business have been presented as discontinued operations in the consolidated financial statements.

On October 19, 2009, we announced that we had completed a private placement of 3,937,500 shares of its common stock with a private investor for an aggregate purchase price of \$1,575,000 or \$.40 per share.

Historically our net cash used in operations has been substantial. Our net cash used in operations for the nine months ended September 30, 2009 was \$5.4 million. Our cash and cash equivalents as of September 30, 2009 was \$318 thousand. We anticipate that we will meet our cash requirements at least into the second quarter of 2010, assuming we are able to fully implement our current costs cutting initiatives, we are able to win additional contracts during fiscal 2009 and we are able to maintain our current customer contracts. We will continue to seek strategic alternatives, including, but not limited to attempting to secure additional financing. Our ability to obtain additional financing in the future will

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

depend in part upon prevailing capital market conditions, as well as conditions in our business and our operating results; and those factors may affect our efforts to arrange additional financing on terms that are satisfactory to us or at all. If we are unable to secure additional financing on terms acceptable to us and on a timely basis, we may significantly reduce our operating costs, which may include the cessation of operations in some countries. Our consolidated financial statements do not include any adjustment to reflect the possible future effects on the recoverability or classification of assets or the amounts and classification of liabilities that may result from the outcome of our ability to continue as a going concern.

The accompanying consolidated financial statements have been prepared on the basis of the Company continuing as a going concern. However, the factors summarized above have raised substantial doubt about our ability to continue as a going concern for the foreseeable future

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. 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 September 30, 2009, the net days revenue outstanding decreased by 4 days to 31 days compared to (35) days at December 31, 2008. Compared to December 31, 2008, accounts receivable decreased \$1.5 million to \$3.1 million at September 30, 2009, primarily due the reduction in overall projects and the related billing schedules.

Table of Contents

Costs and estimated earnings in excess of related billings on uncompleted contracts decreased by \$132 thousand to \$1.3 million as of September 30, 2009 compared to \$1.4 million as of December 31, 2008. The balance at September 30, 2009 primarily consisted of 3 clinical trials. The top two balances constituted 67% and 16% of the balance.

This balance is mostly attributable to a delay in the timing of billings compared to when the work was performed. The \$1.9 million decrease in the liability account, billings in excess of related costs and estimated earnings on uncompleted contracts, to \$1.4 million as of September 30, 2009 from \$3.3 million as of December 31, 2008, is the result of the U.S. business being classified as discontinued operations as of September 30, 2009. Customer advances decreased by \$3.8 million to \$1.4 million from \$5.3 million as of December 31, 2008 due to the U. S. business being classified as discontinued operations as of September 30, 2009.

Our net cash used by operating activities was approximately \$5.4 million for the nine months ended September 30, 2009, compared to net cash used by operating activities of \$3.5 million for the nine months ended September 30, 2008. The \$1.9 million increase is primarily related to decreases in accounts receivable, and other assets and decreases in accounts payable, accrued expenses, billings in excess of related costs and estimated earnings on uncompleted contracts and customer advances for the nine months ended September 30, 2009 as compared to same prior year period. Net cash used by investing activities was \$42 thousand for the nine months ended September 30, 2009 and represented purchases of computer equipment and software applications. This compares to net cash used by investing activities of \$249 thousand for the nine months ended September 30, 2008, which was also used to purchase computer equipment and software applications. Net cash provided by financing activities was \$622 thousand for the nine months ended September 30, 2009, compared with net cash provided by financing activities of \$29 thousand for the nine months ended September 30, 2008. The primary difference related to \$702 thousand of short-term borrowings used to fund operations during the first nine months of 2009.

As a result of these cash flows, our cash and cash equivalents balance at September 30, 2009 was \$318 thousand as compared to \$5.7 million at December 31, 2008.

We purchased approximately \$42 thousand of computer equipment and software applications for nine months ended September 30, 2009. We anticipate capital expenditures of approximately \$100,000 \$125,000 during the remainder of 2009, primarily for leasehold improvements, software applications, workstations, personal computer equipment and related assets.

RECENTLY ISSUED ACCOUNTING STANDARDS:

In June 2009, the FASB issued an accounting standard codified within Accounting Standards Codification (ASC) ASC 105, *Generally Accepted Accounting Principles*, (ASC 105 and formerly referred to as SFAS No. 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. ASC 105 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. As ASC 105 is not intended to change or alter existing GAAP, it will not impact the Company's condensed financial statements. The Company has adjusted historical GAAP references in its third quarter 2009 Form 10-Q to reflect accounting guidance references included in the Codification.

In September 2009, the FASB issued Accounting Standards Update No. 2009-07 (ASC Update 2009-07) *Accounting for Various Topics - Technical Corrections to SEC Paragraphs*. This ASU represents technical corrections to various ASC Topics containing SEC guidance. The technical corrections resulted from external comments received, and consisted principally of paragraph referencing and minor wording changes. In the third quarter of 2009, the Company adopted this FASB ASU. The adoption of this ASU did not have any impact on the condensed financial statements included herein.

In December 2007, the FASB issued ASC 805, *Business Combinations* (ASC 805). ASC 805 revises accounting and reporting standards for business combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses by transferring consideration as well as combinations achieved without the transfer of consideration. By applying the same method of accounting the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, this statement is intended to improve the comparability of the information about business combinations provided in financial reports. ASC 805 applies prospectively to business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently in the process of evaluating ASC 805, and has not yet determined the impact, if any, that accounting for future business combinations under ASC 805, effective January 1, 2009, will have on its consolidated results of operations or financial position.

In August 2009, the FASB issued Accounting Standards Update No 2009-05 (ASC Update 2009-05), an update to FASB ASC 820, *Fair Value Measurements and Disclosures*. This update provides amendments to reduce potential ambiguity in financial reporting when measuring the fair

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

value of liabilities. Among other provisions, this update provides clarification that in circumstances, in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the valuation techniques described in ASC Update 2009-05. ASC Update 2009-05 will become effective for the Company's annual financial statements for the year ended December 31, 2009. The Company has not determined the impact that this update may have on its financial statements.

In June 2009, the FASB issued FAS No. 166, *Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140*. This pronouncement has not yet been incorporated into the FASB's codification. This standard will require more information about transferred financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a Company's first fiscal year beginning after November 15, 2009, or January 1, 2010, for companies reporting earnings on a calendar-year basis. The Company is currently analyzing the impact of this statement, if any, to its condensed financial statements.

In May 2009, the FASB issued an accounting standard codified within ASC 855, *Subsequent Events*, (ASC 855 and formerly referred to as SFAS No. 165), which modified the subsequent event guidance. The three modifications to the subsequent events guidance are: 1) To name the two types of subsequent events either as recognized or non-recognized subsequent events, 2) To modify the definition of subsequent events to refer to events or transactions that occur after the balance sheet date, but before the financial statement are issued or available to be issued and 3) To require entities to disclose the date through which an entity has evaluated subsequent events and the basis for that date, i.e. whether that date represents the date the financial statements were issued or were available to be issued. This guidance is effective for interim or annual financial periods ending after June 15, 2009, and should be applied prospectively. The Company adopted ASC 855 during the quarter ended June 30, 2009 and it did not have a material impact on the Company's condensed financial statements.

In April 2009, the FASB issued an accounting standard codified within ASC 825, *Financial Instruments*, (ASC 825), ASC 825-10-65, *Transition and Open Effective Date Information*, (ASC 825-10-65 and formerly referred to as FSP FAS No. 107-1 and APB Opinion No. 28-1), which requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. This guidance also requires those disclosures in summarized financial information at interim reporting periods. ASC 825-10-65 is effective prospectively for interim reporting periods ending after June 15, 2009. The Company adopted ASC 825 in the quarter ended June 30, 2009. The adoption of ASC 825 did not have a material impact on the Company's condensed financial statements.

In April 2009, the FASB issued an accounting standard codified within ASC 820, *Fair Value Measurements and Disclosures*, (ASC 820 and formerly referred to as FSP FAS 157-4), ASC 820 affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. ASC 820 is effective for interim and annual periods ending after June 15, 2009. The Company adopted ASC 820 in the quarter ended June 30, 2009. The adoption did not have a material impact on the Company's condensed financial statements.

Table of Contents

ITEM 4T. CONTROLS AND PROCEDURES

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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, 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 quarter ended September 30, 2009, and has concluded that there was no change that occurred during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

BUSINESS RISKS

We may not be able to meet our cash requirements without implementing cost cutting initiatives, increasing revenues, and maintaining current customer contracts; failure to do so will result in the need to raise additional capital or significantly reduce our operating costs, which may include the cessation of operations in certain countries.

Historically, our net cash used in operations has been substantial. Our net cash used in operations for the nine months ended September 30, 2009 was \$5.4 million. Our cash and cash equivalents as of September 30, 2009 was \$318 thousand. We anticipate that will meet our cash requirements at least into September of 2010, assuming we are able to fully implement our current costs cutting initiatives, we are able to win additional contracts and we are able to maintain our current customer contracts. In the event we are unable to do so, in order for the Company to continue as a going concern we will be required to obtain additional capital from external sources or significantly reduce our operating costs, which may include the cessation of operations in some countries.

Our ability to obtain additional financing in the future will depend in part upon prevailing capital market conditions, as well as conditions in our business and our operating results; and those factors may affect our efforts to arrange additional financing on terms that are satisfactory to us or at all. Given the current levels of the trading price of the Company's common stock, if the Company were to raise additional capital by issuing equity securities, existing stockholders' percentage ownership would be reduced and they would experience substantial dilution. If we were to raise additional funds by issuing debt securities, these debt securities would have rights, preferences, and privileges senior to those of our common stock, and the terms of the debt securities issued could impose significant restrictions on our operations. If we are unable to obtain additional capital, we will scale back our operations until such capital is obtained or seek stockholder approval to wind down operations and liquidate the company.

The perception that we may not be able to continue as a going concern may adversely affect our business.

Any perception that we may not be able to continue as a going concern may cause others to choose not to deal with us due to concerns about our ability to meet our contractual obligations and may adversely affect our ability to win new contracts and/or raise additional capital.

Our backlog may not be indicative of future results.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Backlog is the amount of revenue that remains to be earned and recognized on written awards, signed contracts and letters of intent. 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. In addition since our backlog is reported in U.S. Dollars, but the majority of our contracts are denominated in currencies other than the U.S. Dollar, changes in the foreign currency exchange rates could reduce the amount of backlog reported.

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 and should not be relied upon.

Our inability to forecast our revenue pipeline or convert revenue pipeline into contracts could increase fluctuations in our revenue and financial results.

We use a pipeline system, a common industry practice, to forecast contract awards and trends in our business. Our management team monitors the status of all potential contract awards, including the potential dollar amount of each contract transaction. We aggregate these estimates periodically to generate a pipeline and then evaluate the pipeline to identify trends in our business. This pipeline analysis and related estimates of revenue may differ significantly from actual revenues in a particular reporting period. When customers delay contracts, reduce the amount of their contract or cancel contracts altogether, it will reduce the rate of conversion of the pipeline into contracts and our revenues will be harmed. Our inability to respond to a variation in the pipeline or in the conversion of the pipeline into contracts in a timely manner, or at all, could cause us to plan or budget inaccurately and thereby could adversely affect our results of operations and financial condition.

Our operating results can be expected to fluctuate from period to period.

Fluctuating operating results are usually due to the level of new business awards in a particular period and the timing of the initiation, progress or cancellation of significant projects. Even a short acceleration or delay in such projects could have a material effect on our results in a given reporting period. Varying periodic results could adversely affect the price of our common stock if investors react to our reporting operating results which are less favorable than in a prior period or lower than those anticipated by investors or the financial community generally.

Table of Contents

Our stock price may continue to experience fluctuations.

The market prices of securities of thinly-traded companies such as ours generally are highly volatile. For example, since January 1, 2008, the price of our common stock reached a high of \$2.42 on February 1, 2008 and a low of \$.10 on August 6, 2009.

In this market environment, the sale of a substantial number of shares of our common stock in the public market or the perception that such a sale might occur would likely have a materially adverse effect on the market price of our common stock.

Any litigation brought against us as a result of this volatility could result in substantial costs and a diversion of our management's attention and resources, which could negatively impact our financial condition, revenues, results of operations, and the price of our common stock.

If we raise additional capital by issuing equity securities in a fluctuating market, many or all of our existing stockholders may experience substantial dilution, and if we need to raise capital by issuing equity securities at a time when our stock price is down, we may have difficulty raising sufficient capital to meet our requirements.

We may incur additional impairment charges which may adversely affect our results of operations.

The Company follows the provisions ASC 805, *Business Combinations* and ASC 350, *Goodwill and Other Intangible Assets*, applicable to business combinations. In accordance with these standards, goodwill acquired in connection with the acquisition of Encorium Oy (formerly Remedium) was not amortized. Under ASC 350, goodwill is subject to impairment testing annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. The Company performed its annual impairment testing as of November 1, 2008. The fair value of the reporting unit was estimated using the expected present value of future cash flows and market values of comparable companies using estimates, judgments and assumptions that Management believes were appropriate in the circumstances. The sum of the fair value was reconciled to the Company's current market capitalization. As a result of this reconciliation process the Company recorded an impairment charge related to goodwill of \$12.5 million in the fourth quarter of 2008. The Company will perform its next impairment testing as of November 1, 2009.

Impairment testing involves various estimates and assumptions, which could vary, and an analysis of relevant market data and market capitalization. If our stock price continues to decline or if economic conditions continue to deteriorate, we may incur additional impairment charges which may adversely impact our results of operations and financial condition.

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

The market for clinical research services is highly competitive. We primarily compete against in-house departments of pharmaceutical, biotechnology and medical device companies and other clinical research organizations. Competitors in our industry range from small, limited-service providers to full service, global clinical 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. In addition, many of our 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 clinical research organizations that have far greater resources and capabilities.

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.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Historically, projects in the fields of cardiovascular, oncology, immunology, vaccines, medical devices as well as clinical staff outsourcing have represented 50-75% of our European project work, although the mix of projects is subject to change from year to year. For the year ended December 31, 2008, net revenues from our three largest clients amounted to 29% of our net revenues, with the three largest clients representing 10%, 10% and 9% of our net revenues, respectively. For the three months ended September 30, 2009, net revenue from our largest clients amounted to 55% of our net revenue, with the largest clients representing 31%, 17% and 7% of net revenue, respectively. The loss of business from any significant client 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. The loss of services of any of our key executives may 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 clinical research organizations, pharmaceutical and biotechnology companies, and academic and research institutions that have 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.

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

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

Table of Contents

investigator recruitment, manufacturing problems resulting in shortages of the product, or our failure to perform our obligations under the contract. For example, in January 2007 a client cancelled a contract having \$12.8 million in revenues remaining. This risk of loss or delay of contracts potentially has greater effect as we pursue larger 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. 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, such as Encorium. 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.

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

A significant portion 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 fixed price contracts, or if we experience significant cost overruns, our business, results of operations and financial condition could be materially and adversely affected. In addition, contracts with our clients are subject to change orders, which occur when the scope of work performed by us needs to be modified from what was originally contemplated by our contract with the client. This can occur, for example, when there is a change in a key study assumption or parameter or a significant change in timing. Under U.S. generally accepted accounting principles, we cannot recognize additional revenue anticipated from change orders until appropriate documentation is received by us from the client authorizing the change made. However, if we incur additional expense in anticipation of receipt of that documentation, we must recognize the expense as incurred. Further, we may not be successful convincing our clients to approve change orders which change the scope of current contracts. Such under-pricing or significant cost overruns could have a material adverse effect on our business, results of operations, financial condition or cash flows.

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 several years, 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 had 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 materially and adversely affect our results of operations. Similar notices could be issued from the regulatory authorities in other countries where we conduct clinical studies. Furthermore, our reputation and prospects for future work could be materially and adversely diminished.

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, state legislatures and foreign governments have considered various types of health care reform in order to control growing health care costs. The United States Congress, state legislatures and foreign governments 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.

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 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 may be materially and adversely affected.

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

Various governments might adopt healthcare legislation or regulations that are more burdensome than existing regulations. These changes 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 and is likely to be proposed in other countries. 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 new privacy requirements and mandating additional privacy procedures for our business, thereby materially and adversely affecting our business, results of operations and financial condition.

Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our business, operating results and financial position.

Recently, general worldwide economic conditions have experienced a downturn due to slower economic activity, concerns about inflation and deflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions, the ongoing effects of the war in Iraq, recent international conflicts and terrorist and military activity,

Table of Contents

and the impact of natural disasters and public health emergencies. If economic growth in the United States and other countries' economies is slowed, many customers may delay or reduce spending on our services, which would harm our business, results of operations and financial condition.

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. 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 effect on our business and results of operations.

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, 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.

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 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 materially and adversely affected if our liability exceeds the amount of our insurance.

Contractual indemnification provisions 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 if the amount we are required to pay 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.

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 payments for achieving specific targets 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.

If we are unable to safeguard our networks and clients' data, our clients may not use our services and our business may be harmed.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Our networks may be vulnerable to unauthorized access, computer hacking, computer viruses and other security problems. An individual who circumvents security measures could misappropriate proprietary information or cause interruptions or malfunctions in our operations. We may be required to expend significant resources to protect against the threat of security breaches or to alleviate problems caused by any breaches. Security measures that we adopt from time to time may be inadequate.

We may have difficulty obtaining director and officer liability insurance in acceptable amounts for acceptable rates.

We cannot assure that we will be able to obtain in the future sufficient director and officer liability insurance coverage at acceptable rates and with acceptable deductibles and other limitations. Failure to obtain such insurance could materially harm our financial condition in the event that we are required to defend against and resolve any future securities class actions or other claims made against us or our management. Further, the inability to obtain such insurance in adequate amounts may impair our future ability to retain and recruit qualified officers and directors.

We do not intend to pay dividends.

We have never paid any cash dividends on our common stock and do not expect to declare or pay any cash or other dividends in the foreseeable future.

We currently fail to meet two of NASDAQ's listing requirements and if our common stock is delisted it could negatively impact the price of our common stock, our ability to access the capital markets and the liquidity of our common stock.

On August 25, 2009, the Company received a letter from The NASDAQ Stock Market notifying the Company that, based on its Form 10-Q for the period ended June 30, 2009, NASDAQ determined that the Company's stockholders' equity did not comply with the minimum \$2.5 million stockholders' equity requirement for continued listing on The NASDAQ Capital Market. As provided in the NASDAQ Marketplace Rules, the Company submitted to NASDAQ a plan and timeline to achieve and sustain compliance. On October 19, 2009, NASDAQ granted the Company an extension until December 8, 2009 to comply. If the Company fails to evidence compliance by that date, its common stock could be delisted from the Nasdaq Capital Market.

On September 15, 2009 Encorium received a NASDAQ Staff Deficiency Letter from The NASDAQ Stock Market stating that for the prior 30 consecutive business days, the closing bid price per share for the Company's common stock was below the \$1.00 minimum per share requirement for continued inclusion under NASDAQ Marketplace Rule 5550(a)(2). The closing price per share for the Company's common stock continues to be below the \$1.00 threshold as of the date of filing of this Form 10-Q. The Company has until March 15, 2010 to regain compliance by maintaining a closing bid price per share of \$1.00 or higher for a minimum of 10 consecutive business days. If the Company is unsuccessful in meeting the minimum bid requirement during this initial compliance period, the Company will receive written notification from NASDAQ that its securities are subject to delisting, and at that time the Company may appeal the delisting determination to a Hearing's Panel. Alternatively, the Company may be eligible for an additional

Table of Contents

grace period of 180 calendar days if the Company meets the initial listing standards, with the exception of bid price. If we fail to comply and cannot remedy our noncompliance during any applicable notice or grace periods, our common stock could be delisted from the NASDAQ Capital Market.

If delisted from the NASDAQ Capital Market, our common stock will likely be quoted in the over-the-counter market in the so-called pink sheets or quoted in the OTC Bulletin Board. In addition, our common stock would be subject to the rules promulgated under the Securities Exchange Act of 1934 relating to penny stocks. These rules require brokers who sell securities that are subject to the rules, and who sell to persons other than established customers and institutional accredited investors, to complete required documentation, make suitability inquiries of investors and provide investors with information concerning the risks of trading in the security. These requirements would make it more difficult to buy or sell our common stock in the open market. In addition, the delisting of our common stock could materially adversely affect our ability to raise capital on terms acceptable to us or at all. Delisting from the NASDAQ Capital Market could also have other negative results, including the potential loss of confidence by clients and employees, the loss of institutional investor interest and fewer business development opportunities.

Failure to comply with Section 404 of the Sarbanes-Oxley Act could negatively impact the market price of our stock Failure to maintain effective internal controls in accordance price.

If, in the future, we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Failure to achieve and maintain an effective internal control environment could negatively impact the market price of our common stock.

If branded pharmaceutical, biotechnology, generic drug or medical device companies reduce their expenditures, our future revenue and profitability may be reduced.

Our business and continued expansion depend on the research and development expenditures of our clients which, in turn, are impacted by their profitability. If these companies want to reduce costs, they may proceed with fewer clinical trials and other drug development. An economic downturn or other factors may cause our clients to decrease their research and development expenditures which could adversely affect our revenues and profitability.

Actions or inspections by regulatory authorities may cause clients not to award future contracts to us or to cancel existing contracts, which may have a material and adverse effect on our results of operations.

We may be subject to continuing inspections of our facilities and documentation in connection with studies we have conducted in support of marketing applications, or routine inspections of our facilities that have yet to be inspected by regulatory authorities. Regulatory authorities can have significant authority over the conduct of clinical trials, and they have the power to take regulatory and legal action in response to violations of clinical standards, subject protection and regulatory requirements in the form of civil and criminal fines, injunctions and other measures. If, for example, the FDA obtains an injunction, such action could result in significant obstacles to future operations. Additionally, there is a risk that actions by regulatory authorities, if they result in significant inspectional observations or other measures, could cause clients not to award us future contracts or to cancel existing contracts. Depending upon the amount of revenue lost, the results could have a material and adverse affect on our results of operations.

We might lose business opportunities as a result of healthcare reform.

Numerous governments have undertaken efforts to control healthcare costs through legislation, regulation and voluntary agreements with healthcare providers and drug companies. Healthcare reform could reduce the demand for our services and, as a result, our revenue. In the last several years, the U.S. Congress has reviewed several comprehensive healthcare reform proposals. The proposals are intended to expand healthcare coverage for the uninsured and reduce the growth of total healthcare expenditures. Congress has also considered and may adopt legislation which could have the effect of putting downward pressure on the prices that pharmaceutical and biotechnology companies can charge for prescription drugs. Any such legislation could cause our customers to spend less on research and development. If this were to occur, we could have fewer clinical trials for our business, which could reduce our earnings. Similarly, pending healthcare reform proposals outside the U.S. could negatively impact revenues from foreign operations.

Our business is subject to international economic, political and other risks that could negatively affect our results of operations or financial position.

Edgar Filing: ENCORIUM GROUP INC - Form 10-Q

Since the sale of our U.S. Business on July 16, 2009, all of our operations are conducted outside the U.S. and we anticipate that revenues from foreign operations will grow. Accordingly, our business is subject to risks associated with doing business internationally, including:

less stable political and economic environments and changes in a specific country's or region's political or economic conditions,

potential negative consequences from changes in tax laws affecting our ability to repatriate profits,

unfavorable labor regulations,

greater difficulties in managing and staffing foreign operations,

the need to ensure compliance with the numerous regulatory and legal requirements applicable to our business in each of these jurisdictions, and to maintain an effective compliance program to ensure compliance,

changes in trade policies, regulatory requirements and other barriers,

civil unrest or other catastrophic events, and

longer payment cycles of foreign customers and difficulty collecting receivables in foreign jurisdictions.

These factors are beyond our control. The realization of any of these or other risks associated with operating in foreign countries could have a material adverse effect on our business, results of operations or financial condition.

We have substantial exposure to currency risks.

Since the sale of our U.S. Business on July 16, 2009, all of our operations are conducted outside the U.S. We operate in many foreign countries and are subject to exchange rate gains and losses for multiple currencies. We may also be subject to foreign currency transaction risk when our service contracts are denominated in a currency other than the currency in which we incur expenses or earn fees related to such contracts. Changes in the exchange rate foreign currencies and the U.S. dollar could materially affect the translation of our subsidiaries' financial results into U.S. dollars for purposes of reporting our consolidated financial results.

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits

- 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.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENCORIUM GROUP, INC.

Dated: November 16, 2009

By: */s/* KAI LINDEVALL, M.D. PH. D.
Kai Lindevall, M.D. Ph. D.
Executive Chairman
(Principal Executive Officer)

Dated: November 16, 2009

By: */s/* PHILIP L. CALAMIA
Philip L. Calamia
Interim Chief Financial Officer
(Principal Accounting Officer)

S-1