ENCORIUM GROUP INC
Form 10-Q
May 05, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010.

OR

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

For the transition period from to

Commission file number: 0-21145

ENCORIUM GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	56-1668867 (I.R.S. Employer Identification No.)
435 Devon Park Drive, Building 500, Wayne, Pennsylvania (Address of principal executive offices)	19087 (Zip Code)

484-588-5400
(Registrant's telephone number, including area code)

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

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 o No o

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	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	x

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: As of April 29, 2011, there were 5,415,500 shares of Encorium Group, Inc. common stock issued, par value $.001 per share, which excludes 38,765 shares in treasury.

ENCORIUM GROUP, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENCORIUM GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

Assets	September 30, 2010 (UNAUDITED)	December 31, 2009
Current Assets		
Cash and cash equivalents	$ 187,566	$ 196,583
Investigator advances	-	19,232
Accounts receivable, less allowance of $317,317 at September 30, 2010 and $412,973 at December 31, 2009	2,975,099	3,454,173
Prepaid expenses and other	1,375,040	872,722
Costs and estimated earnings in excess of related billings on uncompleted contracts	640,079	1,794,134
Debt issuance costs, current, net	75,400	75,400
Current assets of discontinued operations	-	28,832
Total Current Assets	5,253,184	6,441,076
Property and Equipment, Net	429,918	307,552
Goodwill	2,449,822	1,389,045
Other intangibles, net	1,238,030	3,508,310
Debt issuance costs, long-term, net	94,250	150,800
Other assets	431,004	313,524
Total Assets	$ 9,896,208	$ 12,110,307
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	$ 3,283,129	$ 1,756,678
Notes payable	317,340	334,413
Notes payable stockholder	1,782,223	-
Credit Lines	847,680	300,697
Accrued expenses	3,373,869	2,333,099
Deferred taxes	174,883	248,117
Obligations under capital leases	95,590	54,510
Billings in excess of related costs and estimated earnings on uncompleted contracts	1,632,751	1,179,779
Customer advances	1,142,086	1,361,496
Current liabilities of discontinued operations	413,573	607,552
Total Current Liabilities	13,063,124	8,176,341
Long Term Liabilities		
Notes Payable	634,666	668,826
Obligations under capital leases	51,408	52,541

Accrued salaries		121,619		-
Deferred taxes		61,381		837,424
Other liabilities		280,246		104,624
Liability for warrants to purchase common stock		65,000		-
Total Long Term Liabilities		1,214,320		1,663,415
Total Liabilities		14,277,444		9,839,756
Commitments and contingencies				
Stockholders' Equity (Deficit)				
Common stock, $.001 par value 35,000,000 shares authorized, 3,640,802 and 3,426,938 shares issued at September 30, 2010 and December 31, 2009, respectively		3,641		3,427
Additional paid-in capital		35,942,824		35,442,460
Accumulated deficit		(40,199,318)		(33,607,123)
Accumulated other comprehensive income		598,306		1,158,476
		(3,654,547)		2,997,240
Less: Treasury stock, at cost, 38,765 shares		(726,689)		(726,689)
Total Stockholders' Equity (Deficit)		(4,381,236)		2,270,551
Total Liabilities and Stockholders' Equity (Deficit)	$	9,896,208	$	12,110,307

See accompanying notes to the consolidated condensed financial statements.

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ENCORIUM GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue				
Net revenue	$ 2,793,625	$ 4,446,606	$ 9,570,247	$ 13,468,042
Reimbursement revenue	948,479	661,176	2,117,882	2,576,542
Total Revenue	3,742,104	5,107,782	11,688,129	16,044,584
Operating Expenses				
Direct	2,497,427	2,905,878	7,948,416	9,270,853
Reimbursement out-of-pocket expenses	948,479	661,176	2,117,882	2,576,542
Selling, general and administrative	1,953,116	2,058,878	5,763,946	6,379,746
Depreciation and amortization	141,180	98,563	331,721	281,938
Impairment loss	2,779,288	-	2,779,288	-
Total Operating Expenses	8,319,490	5,724,495	18,941,253	18,509,079
Loss from Operations	(4,577,386)	(616,713)	(7,253,124)	(2,464,495)
Interest Expense	(63,543)	(26,676)	(138,519)	(31,132)
Net Interest Expense	(63,543)	(26,676)	(138,519)	(31,132)
Gain on warrants	44,000	-	59,301	-
Net Loss from continuing operations before Income Taxes	(4,596,929)	(643,389)	(7,332,342)	(2,495,627)
Income Tax Expense (Benefit)	(733,496)	98,826	(755,578)	90,899
Net Loss from continuing operations	$ (3,863,433)	$ (742,215)	$ (6,576,764)	$ (2,586,526)
Net loss from discontinued operations	-	(258,436)	(15,431)	(554,016)
Net Loss	$ (3,863,433)	$ (1,000,651)	$ (6,592,195)	$ (3,140,542)
Weighted Average Common and Common Equivalent Shares Outstanding				
Basic and diluted	3,420,876	2,565,485	3,404,485	2,565,485
Net Loss per Common Share				
Continuing Operations	$ (1.13)	$ (0.29)	$ (1.94)	$ (1.00)
Discontinued Operations	$ -	$ (0.10)	$ -	$ (0.22)
Net Loss per Common Share	$ (1.13)	$ (0.39)	$ (1.94)	$ (1.22)

See accompanying notes to the consolidated condensed financial statements.

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ENCORIUM GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2010	2009
Net Cash Used By Operating Activities	$ (801,035)	$ (5,439,361)
Investing Activities:		
Progenitor acquisition, net of cash received	(1,269,949)	-
Purchases of property and equipment	(114,377)	(41,817)
Net Cash Used By Investing Activities	(1,384,326)	(41,817)
Financing Activities:		
Payments under capital leases	(11,096)	(79,830)
Net cash from borrowings - stockholder	1,694,756	-
Net cash from short-term borrowings	559,249	701,335
Net Cash Provided By Financing Activities	2,242,909	621,505
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(66,565)	(527,902)
Net Decrease In Cash and Cash Equivalents	(9,017)	(5,387,575)
Cash and Cash Equivalents, Beginning of Period	196,583	5,705,818
Cash and Cash Equivalents, End of Period	$ 187,566	$ 318,243

See accompanying notes to the consolidated condensed financial statements.

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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. Our mission is to provide our clients with high quality, full-service support for their clinical trials. We offer therapeutic expertise, experienced team management and advanced technologies.

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

We were initially incorporated in August 1998 in Nevada. In June 2002, we changed our state of incorporation to Delaware. In November 2006, we changed our name from Covalent Group, Inc. to Encorium Group, Inc. Prior to November 2006, the Company conducted the majority of its operations in the U.S. while utilizing strategic partnerships with foreign CROs for the provision of services internationally. On November 1, 2006, the Company acquired its wholly-owned subsidiary, Encorium Oy, a CRO founded in 1996 in Finland with offices in offices in Espoo, Turku, Tampere, Oulu and Seinäjoki (Finland), Copenhagen (Denmark), Tallinn (Estonia), Vilnius (Lithuania), Stockholm (Sweden), Bucharest (Romania), Warsaw (Poland), and Ankara (Turkey). Subsequent to the acquisition of Encorium Oy in 2006 the Company managed all of its North American and South American clinical trial studies from its headquarters in Wayne, Pennsylvania and its European and Asian clinical trial studies from Encorium Oy’s facilities in Espoo, Finland. As a result of declining revenues and increased expenses with respect to the Company’s U.S. line of business, 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., as a result of which the Company no longer has any employees or significant operations in the United States.

On July 19, 2010, the Company acquired Progenitor Holding AG, a corporation organized in Switzerland (“Progenitor Holding”) and its operating subsidiaries organized in Mexico, Panama, Argentina, Chile, Switzerland, India and Hong Kong (collectively referred to herein as “Progenitor”). Progenitor is a European headquartered emerging market clinical research organization providing international drug development services in emerging market regions. Pursuant to the terms of a Stock Purchase Agreement on July 19, 2010, the Company purchased from the shareholders of Progenitor Holding all of issued and outstanding shares of Progenitor Holding.

On October 20, 2010, the Company received notification that the NASDAQ Qualifications Panel (the "Panel") determined to delist the Company's securities from The NASDAQ Stock Market, effective with the open of business on October 22, 2010, as a result of the Company's failure to regain compliance with the minimum $2.5 million stockholders' equity requirement. The Company’s common stock is currently quoted on the Pink Sheets. Investors can now view real time stock quotes for HLCS at http://www.otcmarkets.com.

On February 16, 2010, the Company effected a one-for-eight reverse split of its Common Stock effective at 5 PM Eastern Time on February 16, 2010. The Company implemented the reverse stock split under the authority granted to the Board of Directors by the Company's stockholders at the annual meeting of stockholders held on January 8, 2010, to affect a reverse stock split of the Company's Common Stock, par value $0.001 per share, at a ratio within a range of from one-for-three to one-for-ten shares. As a result of the reverse stock split, each eight shares of issued and outstanding shares of the Company Common Stock were combined and reconstituted as one share of Common Stock, par value $0.001 per share, of the Company. The reverse stock split reduced the number of outstanding shares of Common Stock from 27,105,383 shares to 3,388,173 shares. All fractional shares which would have otherwise resulted from the reverse stock split were rounded up to the nearest whole share in lieu of fractional shares. On the Company's balance sheet, the aggregate par value of the issued Common Stock was reduced by reclassifying the par value amount of the eliminated shares of Common Stock to additional paid-in capital. All per share amounts and outstanding shares, including all Common Stock equivalents, stock options, equity compensation plans, and warrants, have been retroactively restated in the Financial Statements and in the Notes to the Financial Statements for all period presented to reflect the reverse stock split.

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The accompanying consolidated condensed financial statements have been prepared on the basis of the company continuing as a going concern.

We anticipate that will meet our cash requirements through September of 2011, assuming we are able to fully implement our current costs cutting initiatives, we are able to win additional contracts during 2011 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 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 was to raise additional capital by issuing equity securities other than to existing stockholders, 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. These factors have raised substantial doubt about our ability to continue as a going concern for the foreseeable future. If we are unable to obtain additional capital, we will scale back our operations until such capital is obtained. Our consolidated condensed 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

The accompanying unaudited Consolidated Condensed Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") 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 the Company 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 Consolidated Condensed Financial Statements should be read in conjunction with the Consolidated Condensed Financial Statements and notes thereto filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 three and nine months ended September 30, 2010 and 2009 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 U.S. Deposits in Europe are generally insured by individual states up to € 50,000 for each account (approximately $68 thousand as of September 30, 2010). Accounts in the U.S. are generally insured up to $250,000 for each account. As of September 30, 2010, our cash and cash equivalents were 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 long-term contracts, which includes a separate cash account to be utilized for payment of investigator fees. As of September 30, 2010 and December 31, 2009, this cash amount was $0 and $20 thousand, respectively. This amount is also included in customer advances within current liabilities in the accompanying balance sheets.

Revenue Recognition

The majority of our net revenue is recognized from fixed price contracts on a proportional performance method based on assumptions regarding the estimated completion of the project. This method is used because management considers total costs incurred to be the best available measure of progress on these contracts. Work is also 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 collectibility is reasonably assured based on our course of dealings with the client. We bear the risk of cost overruns on work performed absent a signed contract modification. Because of the inherent uncertainties in estimating costs, it is reasonably possible that the cost estimates used will change in the near term and may have a material adverse impact on our financial performance.

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In the past, we have had to commit unanticipated resources to complete projects resulting in lower gross margins on those projects. We may experience similar situations in the future. 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 upfront 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 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 collectibility is reasonably assured.

Our operations have experienced, and may continue to experience, period-to-period fluctuations in net 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 are 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, 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 Condensed Statements of Operations.

As is customary in the industry, we will continue to exclude from revenue and expense in the Consolidated Condensed Statements of Operations fees paid to investigators and the associated reimbursement since we acts as an agent on behalf of the pharmaceutical company sponsors with regard to investigator payments. These investigator fees are not reflected in our Net Revenue, Reimbursement Revenue, Reimbursement Out-of-Pocket Expenses, and/or Direct Expenses. The amounts of these investigator fees were $79 thousand and $54 thousand for the three months ended September 30, 2010 and 2009, respectively. The amounts of these investigator fees were $563 thousand and $1.0 million for the nine months ended September 30, 2010 and 2009, respectively.

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Accounts Receivable

Accounts receivable and costs and estimated earnings in excess of related billings on completed contracts represent amounts due from our clients who are concentrated primarily in the pharmaceutical and biotechnology industries.

Concentration of Credit Risk

Our accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts are concentrated with a small number of companies within the pharmaceutical and biotechnology industries. The significant majority of this exposure is to large, well established firms. Credit losses have historically been minimal. As of September 30, 2010 and December 31, 2009, the total of accounts receivable and costs and estimated earnings in excess of related billings on uncompleted contracts was $3.6 million and $5.2 million respectively. The following table sets forth the exposure to our top clients:

	September 30, 2010		December 31, 2009	
	Total of Accounts Receivable and cost and estimated earnings in excess of billings	Percentage	Total of Accounts Receivable and cost and estimated earnings in excess of billings	Percentage
Client A	$ 754,350	21 %	$ 571,896	11 %
Client B	738,537	20 %	-	-
Client C	391,076	11 %	-	-
Client D	202,533	6 %	1,716,077	33 %
Top Clients	$ 2,086,496	58 %	$ 2,287,973	44 %

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. 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 $1.1 million as of September 30, 2010. The balance of customer advances, including investigator advances of $19 thousand, was $1.4 million as of December 31, 2009. As of September 30, 2010 and December 31, 2009, there were no customer advances billed, but not received.

Financial Instruments

The fair value of cash and cash equivalents, restricted cash, accounts receivable, costs and estimated earnings in excess of related billings on uncompleted contracts, accounts payable, accrued expenses and billings in excess of related costs and estimated earnings on uncompleted contracts, notes payable, credit lines, and obligations under capital leases were not materially different than their carrying amounts as reported at September 30, 2010 and December 31, 2009.

As of September 30, 2010, the Company was not a counter party to any forward foreign exchange contracts.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from 3 to 8 years for equipment and furniture and fixtures and the remaining lease term for leasehold improvements and assets under capital lease. Depreciation and amortization, excluding the amortization of intangible assets, for the three months ended September 30, 2010 and 2009 was $25 thousand and $26 thousand, respectively. Depreciation and amortization, excluding the amortization of intangible assets, for the nine months ended September 30, 2010 and 2009 was $82 thousand and $77 thousand, respectively. Expenditures for maintenance and repairs are charged to expense as incurred. When assets are sold, retired, or fully depreciated the cost and accumulated depreciation are removed from the accounts, and any gain or loss on the sale of property and equipment is included in operations.

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Stock-Based Compensation

The Company accounts for stock based compensation in accordance with 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. 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 service period. Accordingly, prior period amounts have not been restated.

Goodwill and Intangible Assets

Goodwill is carried at cost and is not amortized. We test goodwill for impairment on an annual basis on November 1st of each fiscal year, relying on a number of factors including operating results, business plans and anticipated future cash flows. Company management uses its judgment in assessing whether goodwill has become impaired between annual impairment tests. Recoverability of goodwill is evaluated using a two-step process. The first step involves a comparison of the fair value of a reporting unit with its carrying value. If the carrying amount of the reporting unit exceeds its fair value, then proceed to the second step of the process which involves a comparison of the implied fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Definite-lived intangibles are amortized on a straight-line basis over their useful lives. We review our other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

Foreign Currency Translation

Assets and liabilities of the Company's international operations are translated into U.S. dollars at exchange rates in effect on the balance sheet date and equity accounts are translated at historical exchange rates. Revenue and expense items are translated at average exchange rates in effect during the year. Gains or losses from translating foreign currency financial statements are recorded in other comprehensive income.

Income Taxes

The Company accounts for income taxes in accordance with the provisions of 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, 2010, 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. None of the Company's tax filings in these jurisdictions are currently under audit. The Company's policy is to recognize interest and penalties in Other Expense.

Earnings (Loss) Per Share

Earnings (loss) per share is calculated in accordance with ASC 260, "Earnings Per Share" ("ASC 260"). Basic earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares plus the dilutive effect of warrants and outstanding stock options under the Company's equity incentive plans. For 2010 and 2009 diluted net loss per common share is the same as basic net loss per common share, since the effects of potentially dilutive securities are anti-dilutive.

Recently Issued Accounting Standards

In January 2010, the FASB issued ASU No. 2010-6, "Improving Disclosures About Fair Value Measurements", which provides amendments to ASC 820, "Fair Value Measurements and Disclosures" , including requiring reporting entities to make more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements including information on purchases, sales, issuances, and settlements on a gross basis and (4) the transfers between Levels 1, 2, and 3. The standard is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures, which are effective for annual periods beginning after December 15, 2010. The Company adopted the standard for Levels 1 and 2 on January 1, 2010, and does not expect the adoption of the standard for Level 3, on January 1, 2011, to have a material impact on its consolidated financial statements.

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In December 2009, the FASB issued ASU No. 2009-17, "Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities", which amends ASC 810,"Consolidation", to address the elimination of the concept of a qualifying special purpose entity. The standard also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. This standard also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE whereas previous accounting guidance required reconsideration of whether an enterprise was the primary beneficiary of a VIE only when specific events had occurred. The standard provides more timely and useful information about an enterprise's involvement with a variable interest entity and became effective as of the beginning of interim and annual reporting periods that begin after November 15, 2009. The Company adopted the standard on January 1, 2010 and the adoption did not have a material impact on its consolidated financial statements.

The FASB updated ASC Topic 810, "Consolidations" ("ASC Topic 810"), and ASC Topic 860, "Transfers and Servicing " (ASC Topic 860), which significantly changed the accounting for transfers of financial assets and the criteria for determining whether to consolidate a variable interest entity (VIE). The update to ASC Topic 860 eliminates the qualifying special purpose entity (QSPE) concept, establishes conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies the financial asset de-recognition criteria, revises how interests retained by the transferor in a sale of financial assets initially are measured, and removes the guaranteed mortgage securitization re-characterization provisions. The update to ASC Topic 810 requires reporting entities to evaluate former QSPEs for consolidation, changes the approach to determining a VIE's primary beneficiary from a mainly quantitative assessment to an exclusively qualitative assessment designed to identify a controlling financial interest, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a VIE. The Company adopted the provisions of these staff positions effective January 1, 2010. The adoption of these staff positions could impact future transactions entered into by the Company.

In October 2009, the FASB issued ASU 2009-13, "Multiple-Deliverable Revenue Arrangements" (amendments to ASC Topic 605, "Revenue Recognition") ("ASU 2009-13") and ASU 2009-14, "Certain Arrangements that Include Software Elements", (amendments to ASC Topic 985, "Software") ("ASU 2009-14"). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. ASU 2009-13 and ASU 2009-14 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company has evaluated the impact of the adoption of these ASUs on its consolidated results of operations or financial condition, and the adoption did not have a material impact on its consolidated financial statements.

In April 2010, the FASB issued ASU 2010-13, Topic 718, "Compensation—Stock Compensation" ("ASU 2010-13"), which addresses the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades. ASU 2010-13 specifies that a share-based payment awarded that contains a condition that is not a market, performance, or service condition is required to be classified as a liability unless it otherwise qualifies as equity. The amendment is effective for fiscal years, and interim period beginning on or after December 15, 2010. The Company has evaluated the impact of the adoption of this ASU on its consolidated results of operations or financial condition, and the adoption did not have a material impact on its consolidated financial statements.

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