COVANCE INC
Form 10-Q
August 04, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2009

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: 1-12213

COVANCE INC.

(Exact name of Registrant as specified in its Charter)

Delaware	**22-3265977**
(State of Incorporation)	(I.R.S. Employer Identification No.)
210 Carnegie Center, Princeton, New Jersey	**08540**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code: **(609) 452-4440**

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 (the 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 during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). YES x 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 definition of smaller reporting company, accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer x	Accelerated Filer o
Non-Accelerated Filer o	Smaller Reporting Company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of July 24, 2009, the Registrant had 63,973,389 shares of common stock outstanding.

Table of Contents

Covance Inc.

Form 10-Q For the Quarterly Period Ended June 30, 2009

INDEX

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2009 AND DECEMBER 31, 2008

(Dollars in thousands)	June 30, 2009 (UNAUDITED)	December 31, 2008
Assets		
Current Assets:		
Cash and cash equivalents	$ 204,351	$ 221,334
Accounts receivable	281,362	228,951
Unbilled services	105,417	112,719
Inventory	75,962	68,206
Deferred income taxes	16,767	15,029
Prepaid expenses and other current assets	102,735	91,451
Total Current Assets	786,594	737,690
Property and equipment, net	907,185	860,957
Goodwill, net	123,663	105,486
Other assets	49,654	48,955
Total Assets	$ 1,867,096	$ 1,753,088
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 31,940	$ 41,887
Accrued payroll and benefits	80,664	104,607
Accrued expenses and other current liabilities	79,389	86,521
Unearned revenue	174,552	162,556
Short-term debt	58,000	50,000
Income taxes payable	29,693	14,224
Total Current Liabilities	454,238	459,795
Deferred income taxes	52,121	51,385
Other liabilities	50,746	47,059
Total Liabilities	557,105	558,239
Commitments and Contingent Liabilities		
Stockholders Equity:		
Preferred Stock Par value $1.00 per share; 10,000,000 shares authorized; no shares issued and outstanding at June 30, 2009 and December 31, 2008		
Common Stock - Par value $0.01 per share; 140,000,000 shares authorized; 76,125,702 and 75,447,578 shares issued and outstanding, including those held in treasury, at June 30, 2009 and December 31, 2008, respectively	761	754
Paid-in capital	570,243	551,598
Retained earnings	1,212,854	1,129,569
Accumulated other comprehensive income (loss)	1,546	(13,975)
Treasury stock at cost (12,208,912 and 12,150,495 shares at June 30, 2009 and December 31, 2008, respectively)	(475,413)	(473,097)
Total Stockholders Equity	1,309,991	1,194,849
Total Liabilities and Stockholders Equity	$ 1,867,096	$ 1,753,088

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2008

(UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net revenues	$ 466,049	$ 436,912	$ 907,285	$ 849,344
Reimbursable out-of-pocket expenses	23,226	24,911	50,447	46,516
Total revenues	489,275	461,823	957,732	895,860
Cost and expenses:				
Cost of revenue (excluding depreciation and amortization)	313,210	286,884	614,935	560,214
Reimbursable out-of-pocket expenses	23,226	24,911	50,447	46,516
Selling, general and administrative (excluding depreciation and amortization)	69,569	65,242	133,523	124,259
Depreciation and amortization	23,273	17,331	42,887	34,679
Total costs and expenses	429,278	394,368	841,792	765,668
Income from operations	59,997	67,455	115,940	130,192
Other expense (income), net:				
Interest income	(264)	(1,915)	(712)	(4,773)
Interest expense	424	414	789	676
Foreign exchange transaction loss (gain), net	1,241	(481)	795	(1,546)
Gain on sale of business	(655)	(949)	(655)	(3,927)
Other expense (income), net	746	(2,931)	217	(9,570)
Income before taxes and equity investee earnings	59,251	70,386	115,723	139,762
Taxes on income	16,051	20,330	32,400	41,053
Equity investee (loss) earnings	(210)	817	(38)	1,266
Net income	$ 42,990	$ 50,873	$ 83,285	$ 99,975
Basic earnings per share	$ 0.67	$ 0.81	$ 1.31	$ 1.59
Weighted average shares outstanding - basic	63,823,792	62,825,444	63,705,105	63,069,018
Diluted earnings per share	$ 0.67	$ 0.80	$ 1.30	$ 1.56
Weighted average shares outstanding diluted	64,193,664	63,756,789	64,024,143	64,058,649

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008

(UNAUDITED)

(Dollars in thousands)	Six Months Ended June 30 2009	2008
Cash flows from operating activities:		
Net income	$ 83,285	$ 99,975
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42,887	34,679
Non-cash compensation expense associated with employee benefit and stock compensation plans	13,238	12,540
Deferred income tax benefit	(1,387)	(2,277)
Gain on sale of business	(655)	(3,927)
Loss on sale of property and equipment	264	253
Equity investee loss (earnings)	38	(1,266)
Changes in operating assets and liabilities, net of business acquired:		
Accounts receivable	(51,478)	(6,775)
Unbilled services	8,468	(17,914)
Inventory	(7,756)	(6,544)
Accounts payable	(10,040)	(5,512)
Accrued liabilities	(32,000)	(12,331)
Unearned revenue	11,111	(942)
Income taxes payable	15,694	2,565
Other assets and liabilities, net	(13,033)	(6,676)
Net cash provided by operating activities	58,636	85,848
Cash flows from investing activities:		
Capital expenditures	(70,911)	(143,163)
Acquisition of business, net of cash acquired	(18,620)	
Proceeds from sale of business	655	3,927
Other, net	15	96
Net cash used in investing activities	(88,861)	(139,140)
Cash flows from financing activities:		
Net borrowings under revolving credit facility	8,000	35,000
Payment of debt assumed upon acquisition of business	(5,431)	
Stock issued under employee stock purchase and option plans	5,189	14,691
Purchase of treasury stock	(2,316)	(130,427)
Net cash provided by (used in) financing activities	5,442	(80,736)
Effect of exchange rate changes on cash	7,800	10,198
Net change in cash and cash equivalents	(16,983)	(123,830)
Cash and cash equivalents, beginning of period	221,334	319,485
Cash and cash equivalents, end of period	$ 204,351	$ 195,655

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. The balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. You should read these unaudited consolidated financial statements together with the historical consolidated financial statements of Covance Inc. and subsidiaries (Covance or the Company) for the years ended December 31, 2008, 2007, and 2006 included in our Annual Report on Form 10-K for the year ended December 31, 2008.

2. Summary of Significant Accounting Policies

Principles of Consolidation

These unaudited consolidated financial statements include the accounts of all entities controlled by Covance. All significant intercompany accounts and transactions are eliminated. The equity method of accounting is used for investments in affiliates in which Covance owns between 20 and 50 percent and does not have the ability to exercise control. For investments in which Covance owns less than 20 percent and does not have the ability to exercise significant influence over operating or financial decisions of the investee, the cost method of accounting is applied. Where the fair value of the shares of the cost method investee are readily available, Covance accounts for such investments as available-for-sale securities under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). See Note 4.

Use of Estimates

These unaudited consolidated financial statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the

date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Inventory

Inventories, which consist principally of finished goods and supplies, are valued at the lower of cost (first-in, first-out method) or market.

Prepaid Expenses and Other Current Assets

In connection with the management of multi-site clinical trials, Covance pays on behalf of its customers fees to investigators, volunteers and other out-of-pocket costs (such as travel, printing, meetings, couriers, etc.), for which we are reimbursed at cost, without mark-up or profit. Amounts receivable from customers in connection with billed and unbilled investigator fees, volunteer payments and other out-of-pocket pass-through costs are included in prepaid expenses and other current assets in the accompanying consolidated balance sheets and totaled $53.9 million and $52.7 million at June 30, 2009 and December 31, 2008, respectively. See Note 2 Reimbursable Out-of-Pocket Expenses .

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

Goodwill and Other Intangible Assets and Impairment

Goodwill represents costs in excess of the fair value of net tangible and identifiable net intangible assets acquired in business combinations. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, Covance performs an annual test for impairment of goodwill and other indefinite lived intangible assets during the fourth quarter. This test is performed by comparing, at the reporting unit level, the carrying value of the reporting unit to its fair value. Covance assesses fair value based upon its estimate of the present value of the future cash flows that it expects to be generated by the reporting unit. The most recent annual test for impairment performed for 2008 did not identify any instances of impairment and there were no events through June 30, 2009 that warranted a reconsideration of our impairment test results.

Revenue Recognition

Covance recognizes revenue either as services are performed or products are delivered, depending on the nature of the work contracted. Historically, a majority of Covance s net revenues have been earned under contracts which range in duration from a few months to two years, but can extend in duration up to five years or longer. We also have dedicated capacity arrangements with certain clients ranging in duration from one to ten years. Underlying these arrangements are individual project contracts for the specific services to be provided. Dedicated capacity arrangements enable our clients to secure space in our facilities in exchange for which they agree to provide a guaranteed annual minimum dollar value (volume) of work. Under these types of arrangements, if the annual minimum volume commitment is not reached, the client is required to pay Covance for the shortfall. Progress towards the achievement of annual minimum volume guarantees is monitored throughout the year. Annual minimum guarantee shortfalls are included in net revenues when the amount of the shortfall is determinable and realization is assured.

Service contracts generally take the form of fee-for-service or fixed-price arrangements. In cases where performance spans multiple accounting periods, revenue is recognized as services are performed, measured on a proportional-performance basis, generally using output measures that are specific to the service provided. Examples of output measures in our early development segment include the number of slides read, dosings performed, or specimens prepared for preclinical laboratory services, or number of dosings or number of volunteers enrolled for clinical pharmacology. Examples of output measures in our late-stage development segment s clinical development service offering include among others, number of investigators enrolled, number of sites initiated, number of patients enrolled and number of monitoring visits completed. Revenue is determined by dividing the actual units of work completed by the total units of work required under the contract and multiplying that percentage by the total contract value. The total contract value, or total contractual payments, represents the aggregate contracted price for each of the agreed upon services to be provided. We do not have any contractual arrangements spanning multiple accounting periods where revenue is recognized on a proportional-performance basis under which we have earned more than an immaterial amount of performance-based revenue (i.e. potential additional revenue tied to specific deliverables or performance). Changes in the scope of work are common, especially under

long-term contracts, and generally result in a change in contract value. Once the client has agreed to the changes in scope and renegotiated pricing terms, the contract value is amended and revenue is recognized as described above. Estimates of costs to complete are made to provide, where appropriate, for losses expected on contracts. Costs are not deferred in anticipation of contracts being awarded, but instead are expensed as incurred.

Billing schedules and payment terms are generally negotiated on a contract-by-contract basis. In some cases, we bill the client for the total contract value in progress-based installments as we reach certain non-contingent billing milestones over the contract duration, such as, but not limited to, contract signing, initial dosing, investigator site initiation, patient enrollment or database lock. The term billing milestone relates only to a billing trigger in a contract whereby amounts become billable and payable in accordance with a negotiated predetermined billing schedule throughout the term of a project. These billing milestones are not performance-based (i.e., potential additional arrangement consideration tied to specific deliverables or performance). In other cases, billing and payment terms are tied to the passage of time (e.g., monthly billings). In either case, the total contract value and aggregate amounts billed to the client would be the same at the end of the project. While we attempt to negotiate terms that provide for billing and payment of services prior to or within close proximity to the provision of services, this is not always the case, as evidenced by fluctuations in the levels of unbilled receivables and unearned revenue

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

from period to period. While a project is ongoing, cash payments are not necessarily representative of aggregate revenue earned at any particular point in time, as revenues are recognized when services are provided, while amounts billed and paid are in accordance with the negotiated billing and payment terms.

In some cases, payments received are in excess of revenue recognized. For example, a contract invoicing schedule may provide for an upfront payment of 10% of the full contract value upon contract signing, but at the time of signing, performance of services has not yet begun, and therefore, no revenue has yet been recognized. Payments received in advance of services being provided, such as in this example, are deferred as unearned revenue on the balance sheet. As the contracted services are subsequently performed and the associated revenue is recognized, the unearned revenue balance is reduced by the amount of revenue recognized during the period.

In other cases, services may be provided and revenue is recognized before we have invoiced the client. In these cases, revenue recognized will exceed amounts billed, and the difference, representing an unbilled receivable, is recorded for this amount that is currently unbillable to the customer pursuant to contractual terms. Once we have invoiced the client, the unbilled receivable is reduced for the amount billed, and a corresponding account receivable is recorded. All unbilled receivables are billable to customers within one year from the respective balance sheet date.

Most contracts are terminable by the client either immediately or upon notice. These contracts typically require payment to Covance of expenses to wind down the study, fees earned to date and, in some cases, a termination fee or a payment to Covance of some portion of the fees or profits that could have been earned by Covance under the contract if it had not been terminated early. Termination fees are included in net revenues when realization is assured. In connection with the management of multi-site clinical trials, Covance pays on behalf of its customers fees to investigators, volunteers and other out-of-pocket costs (such as for travel, printing, meetings, couriers, etc.), for which it is reimbursed at cost, without mark-up or profit. Investigator fees are not reflected in total revenues or expenses where Covance acts in the capacity of an agent on behalf of the pharmaceutical company sponsor, passing through these costs without risk or reward to Covance. All other out-of-pocket costs are included in total revenues and expenses.

Taxes

Covance uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amount of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the temporary differences are expected to reverse. The effect on deferred taxes of a change in enacted tax rates is recognized in income in the period when the change is effective.

The Company accounts for uncertain income tax positions in accordance with the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). Under the guidance of FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not to be sustained upon examination based on the technical merits of the position. The amount of the accrual for which an exposure exists is measured as the largest amount of benefit determined on a cumulative probability basis that the Company believes is more likely than not to be realized upon ultimate settlement of the position. Components of the reserve are classified as either a current or long-term liability in the consolidated balance sheet based on when the Company expects each of the items to be settled. Covance records interest and penalties accrued in relation to unrecognized tax benefits as a component of income tax expense.

As of June 30, 2009, the balance of the reserve for unrecognized tax benefits was $12.3 million, including accrued interest of $1.6 million, of which $3.4 million is recorded as a current liability in accrued expenses and other current liabilities, and $8.9 million is recorded as a long-term liability in other liabilities on the consolidated balance sheet. As of December 31, 2008, the balance of the reserve for unrecognized tax benefits was $11.9 million, including accrued interest of $1.2 million, of which $3.3 million was recorded as a current liability in accrued expenses and other current liabilities, and $8.6 million was recorded as a long-term liability in other liabilities on the consolidated balance sheet. This reserve relates to exposures for income tax matters such as transfer pricing, nexus, deemed income and research and development credits. The net increase in the reserve

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

for unrecognized tax benefits from December 31, 2008 to June 30, 2009 resulted from the accrual of interest on existing reserves.

The Company also maintains a tax reserve related to exposures for non-income tax matters including value-added tax and state sales and use and other taxes, which are accounted for in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. The balance of this reserve at both June 30, 2009 and December 31, 2008 is $0.9 million and is recorded as a current liability in accrued expenses and other current liabilities on the consolidated balance sheet.

While Covance believes it has identified all reasonably identifiable exposures and the reserve it has established for identifiable exposures is appropriate under the circumstances, it is possible that additional exposures exist and that exposures may be settled at amounts different than the amounts reserved. It is also possible that changes in facts and circumstances could cause Covance to either materially increase or reduce the carrying amount of its tax reserve.

Covance s historical policy has been to leave its unremitted foreign earnings invested indefinitely outside the United States. Covance intends to continue to leave its unremitted foreign earnings invested indefinitely outside the United States. As a result, taxes have not been provided on any of the remaining accumulated foreign unremitted earnings as of June 30, 2009.

Comprehensive Income

Covance s total comprehensive income represents net income plus the change in the cumulative translation adjustment equity account for the periods presented. For the three and six months ended June 30, 2009, comprehensive income also includes the increase (decrease) in the unrealized gain on available-for-sale securities of $0.1 million and ($0.1 million), net of tax, respectively, resulting from the change in the classification of Covance s minority equity investment in Bio-Imaging Technologies, Inc. (BIOC) to an available-for-sale security in accordance with SFAS 115 in the fourth quarter of 2008. Total comprehensive income was $72.7 million and $42.2 million for the three months ended June 30, 2009 and 2008, respectively, and $98.8 million and $116.0 million for the six months ended June 30, 2009 and 2008, respectively.

Reimbursable Out-of-Pocket Expenses

As discussed in Note 2 Prepaid Expenses and Other Current Assets , Covance pays on behalf of its customers fees to investigators, volunteers and other out-of-pocket costs for which the Company is reimbursed at cost, without mark-up or profit. In connection with the requirements of Financial Accounting Standards Board Emerging Issues Task Force Rule No. 01-14 (EITF 01-14), *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred*, amounts paid to volunteers and other out-of-pocket costs are reflected in operating expenses, while the reimbursements received are reflected in revenues in the consolidated statements of income. Covance will continue to exclude from revenue and expense in the consolidated statements of income fees paid to investigators and the associated reimbursement since Covance acts as an agent on behalf of the pharmaceutical company sponsors with regard to investigator payments, in accordance with the Financial Accounting Standards Board Emerging Issues Task Force Rule No. 99-19 (EITF 99-19), *Reporting Revenue Gross as a Principal Versus Net as an Agent*.

Stock-Based Compensation

The Company sponsors several stock-based compensation plans pursuant to which non-qualified stock options and restricted stock awards are granted to eligible employees. These plans are described more fully in Note 8 herein and Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008. The Company recognizes stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payments*, (SFAS 123R) pursuant to which the grant-date fair value of awards expected to vest is expensed on a straight-line basis over the vesting period of the related awards.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

Defined Benefit Pension Plans

The Company sponsors various pension and other post-retirement benefit plans. These plans are described more fully in Note 7 herein and Note 9 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008. The measurement of the related benefit obligations and the net periodic benefit costs recorded each year are based upon actuarial computations, which require management s judgment as to certain assumptions. These assumptions include the discount rates to use in computing the present value of the benefit obligations and the net periodic benefit costs, the expected future rate of salary increases (for pay-related plans) and the expected long-term rate of return on plan assets (for funded plans). The discount rates are derived based on a hypothetical yield curve represented by a series of annualized individual discount rates. The expected long-term rate of return on plan assets is based on the target asset allocation and the average expected rate of growth for the asset classes invested. The average expected rate of growth is derived from a combination of historic returns, current market indicators, the expected risk premium for each asset class and the opinion of professional advisors.

Effective December 31, 2008, Covance adopted the measurement date provisions of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements Nos. 87, 88, 106 and 132(R)* (SFAS 158). The measurement date provision of SFAS 158 eliminated the early measurement date option and requires a plan s funded status to be measured as of the employer s fiscal year end. As such, liabilities related to all of Covance s pension and other post-retirement benefit plans are now measured as of December 31.

Earnings Per Share (EPS)

Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued; computed under the treasury stock method in accordance with the requirements of Statement of Financial Accounting Standards No. 128, *Earnings Per Share*.

In computing diluted EPS for the three months ended June 30, 2009 and 2008, the denominator was increased by 369,872 shares and 931,345 shares, respectively, and for the six months ended June 30, 2009 and 2008, the denominator was increased by 319,038 shares and 989,631 shares, respectively, representing the dilutive effect of stock options outstanding at June 30, 2009 and 2008 with exercise prices less than the average market price of Covance s common stock during each respective period. Excluded from the computation of diluted EPS for the three months ended June 30, 2009 were options to purchase 1,162,798 shares of common stock at prices ranging from $42.25 to $94.34 per share

because the exercise prices of such options were greater than the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the six months ended June 30, 2009 were options to purchase 1,168,143 shares of common stock at prices ranging from $40.18 to $94.34 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the three months ended June 30, 2008 were options to purchase 17,177 shares of common stock at prices ranging from $83.23 to $87.33 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the six months ended June 30, 2008 were options to purchase 15,400 shares of common stock at prices ranging from $86.02 to $87.33 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period.

Supplemental Cash Flow Information

Cash paid for interest for each of the six month periods ended June 30, 2009 and 2008 was $0.6 million. Cash paid for income taxes for the six month periods ended June 30, 2009 and 2008 totaled $20.0 million and $37.6 million, respectively. The change in income taxes payable in the consolidated statement of cash flows for the six months ended June 30, 2009 and 2008 includes as an operating cash outflow the excess tax benefit received from the exercise of non-qualified stock options as measured under SFAS 123R of $0.04 million and $2.9 million, respectively (a corresponding cash inflow of $0.04 million and $2.9 million, respectively, has been included in financing cash flows).

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

Recently Issued Accounting Standards

In December 2008, the Financial Accounting Standards Board (the FASB) issued FASB Staff Position 132(R)-1 (FSP 132(R)-1), which provides guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. FSP 132(R)-1 requires disclosure of investment allocation methodologies and information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets in order to provide users with an understanding of significant concentrations of risk in plan assets. FSP 132(R)-1 is effective for years ending after December 15, 2009. FSP 132(R)-1 requires additional disclosure only and therefore will not impact Covance s consolidated results of operations or financial position.

In April 2009, the FASB issued FASB Staff Position 107-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1) to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* and APB Opinion No. 28, *Interim Financial Reporting* (APB 28). FSP 107-1 is effective for interim reporting periods ending after June 15, 2009 and was adopted by Covance during the quarter ended June 30, 2009. FSP 107-1 requires additional disclosure only and therefore did not impact Covance s results of operations or financial position. See Notes 4 and 6 for information related to the fair value of Covance s financial instruments.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes general standards of disclosure about events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009 and was adopted by Covance during the quarter ended June 30, 2009. SFAS 165 requires additional disclosure only and therefore did not impact Covance s results of operations or financial position. See Note 10.

Subsequent Events

In accordance with the adoption of SFAS 165, subsequent events are defined as those events or transactions that occur after the balance sheet date, but before the financial statements are filed with the Securities and Exchange Commission. See Note 10.

3. Treasury Stock

In February 2007, the Covance Board of Directors authorized the repurchase of an additional 3.0 million shares under Covance s stock repurchase program. At June 30, 2009, there are approximately 0.8 million shares remaining for purchase under the 2007 authorization. Covance also reacquires shares of its common stock in connection with certain employee benefit plans primarily when employees tender shares to satisfy income tax withholdings associated with the vesting of stock awards. The following table sets forth the treasury stock activity during the six month periods ended June 30, 2009 and 2008.

	Six Months Ended June 30			
	2009		2008	
(amounts in thousands)	**$**	**# shares**	**$**	**# shares**
Shares repurchased in connection with:				
Board approved buyback programs	$		$ 126,709	1,500.0
Employee benefit plans	2,316	58.4	3,718	44.8
Total	$ 2,316	58.4	$ 130,427	1,544.8

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

4. Equity Investments

In December 2008, Covance acquired a minority equity position (less than 20%) in Caprion Proteomics (Caprion), a privately held company headquartered in Montreal, Canada for a total cost of $3.1 million. Caprion is a leading provider of proteomics-based services to the pharmaceutical industry. Under the terms of the agreement, Covance will serve as the exclusive contract research organization distributor of Caprion s proteomic biomarker services and Caprion will serve as Covance s exclusive proteomic discovery provider. As Covance owns less than a 20% interest in Caprion and does not exercise significant influence over the operating or financial decisions of Caprion, the investment is accounted for under the cost method of Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. This investment is included in other assets on the consolidated balance sheet.

Covance has a 47% minority equity position in Noveprim Limited (Noveprim), a supplier of research products, which was acquired in March 2004 at a total cost of $20.7 million. The excess of the purchase price over the underlying equity in Noveprim s net assets at the date of acquisition of $13.8 million represents goodwill and is included in the carrying value of Covance s investment. This investment is reflected in other assets on the consolidated balance sheet. During the three and six month periods ended June 30, 2009, Covance recognized losses of $0.2 million and $0.04 million, respectively, representing its share of Noveprim s losses, including the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2009. During the three and six month periods ended June 30, 2008, Covance recognized $0.7 million and $1.0 million, respectively, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2008. The carrying value of Covance s investment in Noveprim at June 30, 2009 and December 31, 2008 was $22.5 million and $23.4 million, respectively.

Covance has a minority equity position (less than 20%) in BioClinica, Inc. (BIOC) (Nasdaq GM:BIOC), formerly known as Bio Imaging Technologies, Inc. BIOC uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. During the three and six month periods ended June 30, 2008, Covance recognized income of $0.1 million and $0.3 million, respectively, representing its pro rata share of BIOC s earnings. In the fourth quarter of 2008, Covance suspended the use of the equity method of accounting as its ownership interest in BIOC fell below 20% and it could no longer exercise significant influence over BIOC s operations. In the fourth quarter of 2008, Covance began accounting for its investment in BIOC as an available-for-sale security in accordance with SFAS 115. The carrying value of Covance s investment in BIOC as of June 30, 2009 and December 31, 2008 was $8.4 million and $8.6 million, respectively, as determined based on quoted market prices in an active market. The $0.2 million decrease in the carrying value of the investment results in a $0.1 million reduction in the unrealized gain on investment, net of tax, which is included within accumulated other comprehensive income on the consolidated balance sheet. Accordingly, the balance in the unrealized gain on investment at June 30, 2009 and December 31, 2008 was

$4.2 million and $4.4 million, net of tax, respectively.

5. Acquisitions and Divestitures

In March 2009, Covance acquired 100% of the stock of Swiss Pharma Contract Ltd. (Swiss Pharma), and its 50-bed clinical research facility based in Basel, Switzerland, for cash payments aggregating $19.4 million ($18.6 million net of cash acquired). Additionally, Covance repaid the entire $5.4 million balance of mortgage debt assumed in the Swiss Pharma acquisition. Transaction related costs of $0.5 million were reported as selling, general & administrative expense in the period incurred. This acquisition expands Covance s clinical pharmacology presence in Europe and provides access to special patient populations for Phase I/IIa clinical studies. Swiss Pharma s assets and liabilities acquired were included in the consolidated balance sheet at March 31, 2009 based on their estimated fair value as determined in a preliminary purchase price allocation. Results of operations for Swiss Pharma are reported in Covance s early development segment.

In addition to the initial cash consideration of $19.4 million, Covance accrued a liability of $3.4 million for the estimated fair value of future contingent consideration expected to be payable by Covance based upon Swiss Pharma reaching specific performance metrics over the next three years of operation. The potential contingent consideration in this transaction ranges from zero to $4.6 million and is payable in three annual installments based upon operational performance in 2009, 2010 and 2011. The table below summarizes the preliminary purchase price allocation for the Swiss Pharma acquisition:

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

Estimated fair value of tangible assets and liabilities acquired:		
Cash	$	750
Accounts receivable and unbilled, net		1,987
Property and equipment		7,465
Unearned revenue		(838)
Mortgage debt		(5,436)
Other net liabilities		(1,116)
Fair value of intangible assets acquired (7 year weighted average useful life):		
Customer list (10 year useful life)		1,243
Non-compete agreements (3 year useful life)		437
Order backlog (1 year useful life)		162
Goodwill		18,177
Net assets acquired	$	22,831

Intangible assets will be amortized on a straight-line basis over their estimated useful lives. The estimated amortization expense expected to be recorded in future periods is as follows:

2009	$	364
2010		270
2011		270
2012		161
2013		124
2014 and beyond		653
	$	1,842

The purchase price allocation is based upon preliminary estimates pending completion of a closing balance sheet, using available information and making assumptions management believes are reasonable. Accordingly, the purchase price allocation is subject to finalization. The goodwill of $18.2 million resulting from the acquisition arises largely from the synergies expected from combining the Swiss Pharma operations with our existing European clinical pharmacology operations, as well as from the benefits derived from the assembled Swiss Pharma workforce. None of the goodwill recognized is expected to be deductible for tax purposes.

In October 2008, Covance acquired certain assets from Eli Lilly and Company (Lilly) for cash payments totaling $51.6 million (including transaction related costs of $1.6 million). The acquired assets consisted of 450-acres of Lilly s early drug development campus (land, buildings and equipment) located in Greenfield, Indiana (Greenfield). In addition, Covance and Lilly entered into a 10-year agreement with a minimum value of $1.6 billion pursuant to which Covance will provide Lilly a broad range of drug development services. The results of operations for Greenfield and the acquired assets, which are now part of Covance s early development segment, are included in Covance s consolidated financial

statements beginning in October 2008.

In November 2007, Covance sold its centralized ECG business (Cardiac Safety Services), part of Covance s late-stage development segment, to eResearchTechnology Inc. (eRT) for initial cash proceeds of $35.2 million and a pre-tax gain of $6.6 million ($4.1 million after tax). Simultaneously therewith, Covance entered into a ten year marketing agreement with eRT under which Covance will continue to offer its clients cardiac safety services. During the three months ended June 30, 2009 and 2008 and the six month period ended June 30, 2008, Covance received additional proceeds from this sale reflecting contingent consideration related to transferred backlog totaling $0.6 million, $0.9 million and $3.9 million, respectively, and recognized an additional pre-tax gain of $0.6 million, $0.9 million and $3.9 million, ($0.4 million, $0.6 million and $2.6 million after tax), respectively. Covance may receive up to approximately $7.4 million in additional future contingent consideration relating to transferred backlog and revenues generated by eRT from new contracts secured under the first three years of the marketing agreement. In addition, Covance expects to receive referral fees during the term of the long-term marketing agreement.

See Note 10. Subsequent Events.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

6. Short-Term Debt

On June 16, 2009, Covance entered into a new $150.0 million revolving credit facility (the Credit Facility) which replaced its credit facility which was due to expire on June 30, 2009. The Credit Facility may be expanded to $200.0 million at Covance s election. At June 30, 2009, there were $58.0 million of outstanding borrowings and $1.4 million of outstanding letters of credit under the Credit Facility. At December 31, 2008, there were $50.0 million of outstanding borrowings and $1.4 million of outstanding letters of credit under the previous credit facility. Interest on all outstanding borrowings under the Credit Facility is based upon the London Interbank Offered Rate (LIBOR) plus a 200 basis point margin. Interest on all outstanding borrowings under the previous credit facility was based upon LIBOR plus a 75 basis point margin. Interest on outstanding borrowings approximated 1.33% and 3.42% per annum during the six months ended June 30, 2009 and 2008, respectively. Costs associated with the Credit Facility, which expires in June 2012, consisted primarily of bank and legal fees totaling $0.9 million which will be amortized over the three year facility term. The carrying value of amounts drawn under the Credit Facility approximate fair value based on their short-term nature and the indexed interest rate. The Credit Facility contains various financial and other covenants and is collateralized by guarantees of certain of Covance s domestic subsidiaries and a pledge of 65 percent of the capital stock of certain of Covance s foreign subsidiaries. At June 30, 2009, Covance was in compliance with the terms of the Credit Facility.

7. Defined Benefit Plans

Covance sponsors various pension and other post-retirement benefit plans. As of December 31, 2008, Covance adopted the measurement date provisions of SFAS 158. Each of the benefit plans described below has a 2008 measurement date of December 31. Prior to 2008, the measurement dates for the various plans ranged from September 30 to December 31.

Defined Benefit Pension Plans

Covance sponsors two defined benefit pension plans for the benefit of its employees at two United Kingdom subsidiaries and one defined benefit pension plan for the benefit of its employees at a German subsidiary, all of which are legacy plans of previously acquired companies. Benefit amounts for all three plans are based upon years of service and compensation. The German plan is unfunded while the United Kingdom plans are funded. Covance s funding policy has been to contribute annually a fixed percentage of the eligible employee s salary at least equal to the local statutory funding requirements. Pension plan assets are administered by the plans trustees and are principally invested in equity and debt securities. The components of net periodic pension expense for these plans for the three and six month periods ended June 30, 2009 and 2008 are as follows:

	United Kingdom Plans Three Months Ended June 30		German Plan Three Months Ended June 30	
	2009	2008	2009	2008
Components of Net Periodic Pension Cost:				
Service cost	$ 828	$ 1,379	$ 137	$ 146
Interest cost	1,892	2,063	142	138
Expected return on plan assets	(1,986)	(2,341)		
Amortization of net actuarial loss	306	318	1	14
Participant contributions	(508)	(527)		
Net periodic pension cost	$ 532	$ 892	$ 280	$ 298
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	6.25%	5.50%	6.25%	5.60%
Expected rate of return on assets	6.75%	6.75%	n/a	n/a
Salary increases	4.25%	4.25%	3.00%	3.00%

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

	United Kingdom Plans Six Months Ended June 30		German Plan Six Months Ended June 30	
	2009	2008	2009	2008
Components of Net Periodic Pension Cost:				
Service cost	$ 1,561	$ 2,762	$ 270	$ 292
Interest cost	3,568	4,138	279	277
Expected return on plan assets	(3,745)	(4,694)		
Amortization of net actuarial loss	577	637	3	25
Participant contributions	(958)	(1,058)		
Net periodic pension cost	$ 1,003	$ 1,785	$ 552	$ 594
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	6.25%	5.50%	6.25%	5.60%
Expected rate of return on assets	6.75%	6.75%	n/a	n/a
Salary increases	4.25%	4.25%	3.00%	3.00%

Supplemental Executive Retirement Plan

In addition to these foreign defined benefit pension plans, Covance also has a non-qualified Supplemental Executive Retirement Plan (SERP). The SERP, which is not funded, is intended to provide retirement benefits for certain executive officers of Covance. Benefit amounts are based upon years of service and compensation of the participating employees. The components of net periodic pension cost for the three and six month periods ended June 30, 2009 and 2008 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Components of Net Periodic Pension Cost:				
Service cost	$ 425	$ 308	$ 849	$ 617
Interest cost	149	217	298	434
Amortization of prior service cost (credit)	(30)	(30)	(59)	(59)
Amortization of net actuarial loss		27		53
Net periodic pension cost	$ 544	$ 522	$ 1,088	$ 1,045
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	6.00%	5.50%	6.00%	5.50%
Salary increases	4.00%	4.00%	4.00%	4.00%

Post-Employment Retiree Health and Welfare Plan

Covance also sponsors a post-employment retiree health and welfare plan for the benefit of eligible employees at certain U.S. subsidiaries who retire after satisfying service and age requirements. This plan is funded on a pay-as-you-go basis and the cost of providing these benefits is shared with the retirees. The components of net periodic post-retirement benefits cost for the three and six month periods ended June 30, 2009 and 2008 are as follows:

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Components of Net Periodic Post-retirement Benefits Cost:				
Service cost	$ 28	$ 39	$ 56	$ 77
Interest cost	82	81	164	162
Net periodic post-retirement benefits cost	$ 110	$ 120	$ 220	$ 239
Assumptions Used to Determine Net Periodic Post-retirement Benefit Cost:				
Discount rate	6.00%	5.50%	6.00%	5.50%
Health care cost trend rate	8.00%(a)	9.00%(a)	8.00%(a)	9.00%(a)

(a) decreasing to ultimate trend of 5.00% in 2014

8. Stock-Based Compensation Plans

Covance sponsors several employee stock-based compensation plans which are described more fully in Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

In May 2007, Covance s shareholders approved the 2007 Employee Equity Participation Plan (the 2007 EEPP) in replacement of the 2002 Employee Equity Participation Plan (the 2002 EEPP). Effective upon approval of the 2007 EEPP, no further grants or awards were permitted under the 2002 EEPP. Shares remaining for grant under the 2002 EEPP are available for grant under the 2007 EEPP. In addition, the Covance Board of Directors directed that, effective May 3, 2007, no further grants would be permitted under the 2002 Employee Stock Option Plan (the 2002 ESOP) and, unlike the 2002 EEPP, shares remaining for grant under the 2002 ESOP are not available for grant under the 2007 EEPP. The 2007 EEPP became effective on May 3, 2007 and will expire on May 2, 2017. The 2007 EEPP authorizes the Compensation and Organization Committee of the Board of Directors (the Compensation Committee), or such committee as is appointed by the Covance Board of Directors, to administer the 2007 EEPP, to grant awards to employees and consultants of Covance or entities in which Covance has a controlling or significant equity interest. The 2007 EEPP authorizes the Compensation Committee to grant the following awards: options to purchase common stock; stock appreciation rights; and other stock awards either singly or in combination. The exercise period for stock options granted under the 2007 EEPP is determined by the Compensation Committee at the time of grant, and is generally ten years from the date of grant. The vesting period for stock options and stock awards granted under the 2007 EEPP is determined by the Compensation Committee at the time of grant. Generally, options vest over a three year period for senior executives and over a two or three year period for all other optionees. Stock awards generally vest over a three year period for all employees. The number of shares of Covance common stock initially available for grant under the 2007 EEPP totaled approximately 1.6 million plus approximately 3.3 million shares remaining available under the 2002 EEPP at the time the

2007 EEPP was approved. All stock option grants under the 2002 EEPP remaining outstanding are now administered in accordance with the provisions of the 2002 EEPP out of shares issuable under the 2007 EEPP. The Company issues authorized but previously unissued shares when options are exercised or for stock awards. There have been no grants of stock appreciation rights or grants of options to purchase common stock or stock awards to consultants of Covance or employees or consultants of entities in which Covance has a controlling or significant equity interest under the 2002 ESOP, the 2002 EEPP or the 2007 EEPP. At June 30, 2009 there were approximately 2.8 million shares remaining available for option grants or stock awards under the 2007 EEPP, up to 0.9 million of which are available for issuance as stock awards.

The grant-date fair value of stock option awards is estimated using an option pricing model as more fully described in Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008. The grant-date fair value of options expected to vest is expensed on a straight-line basis over the vesting period of the related awards.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

The following table sets forth the weighted-average assumptions used to calculate the fair value of options granted for the three and six month periods ended June 30, 2009 and 2008:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Expected stock price volatility	36%	39%	36%	39%
Risk free interest rate(s)	0.3% - 2.6%	1.9% - 3.7%	0.3% - 2.6%	1.9% - 3.7%
Expected life of options (years)	4.6	4.4	4.6	4.4

Restricted stock awards are granted subject to certain restrictions, including in some cases service conditions and in other cases service and performance conditions. The grant-date fair value of restricted stock and performance-based awards, which has been determined based upon the market value of Covance s shares on the grant date, is expensed on a straight-line basis over the vesting period of the related awards.

Covance also has an employee stock purchase plan (ESPP) pursuant to which Covance may make available for sale to its employees shares of its common stock at a price equal to 85% of the lower of the market value on the first or last day of each calendar quarter. The ESPP is intended to give Covance employees the opportunity to purchase shares of Covance common stock through payroll deductions.

Results of operations for the three month period ended June 30, 2009 include total stock-based compensation expense of $7.4 million ($5.0 million net of tax benefit of $2.4 million), $3.1 million of which has been included in cost of revenue and $4.3 million of which has been included in selling, general and administrative expenses. Results of operations for the six month period ended June 30, 2009 include total stock-based compensation expense of $13.2 million ($8.9 million net of tax benefit of $4.3 million), $5.4 million of which has been included in cost of revenue and $7.8 million of which has been included in selling, general and administrative expenses. Results of operations for the three month period ended June 30, 2008 include total stock-based compensation expense of $6.5 million ($4.4 million net of tax benefit of $2.1 million), $2.5 million of which has been included in cost of revenue and $4.0 million of which has been included in selling, general and administrative expenses. Results of operations for the six month period ended June 30, 2008 include total stock-based compensation expense of $12.6 million ($8.5 million net of tax benefit of $4.1 million), $4.8 million of which has been included in cost of revenue and $7.8 million of which has been included in selling, general and administrative expenses.

9. Segment Information

Covance has two reportable segments: early development and late-stage development. Early development services, which includes Covance s preclinical and clinical pharmacology service capabilities, involve evaluating a new compound for safety and early effectiveness as well as evaluating the absorption, distribution, metabolism and excretion of the compound in the human body. It is at this stage that a pharmaceutical company, based on available data, will generally decide whether to continue further development of a drug. Late-stage development services, which include Covance s central laboratory, clinical development, periapproval and market access services, are geared toward demonstrating the clinical effectiveness of a compound in treating certain diseases or conditions, obtaining regulatory approval and maximizing the drug s commercial potential. The accounting policies of the reportable segments are the same as those described in Note 2.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

June 30, 2009 and 2008

(dollars in thousands, unless otherwise indicated)

Segment revenues, operating income and total assets for the three and six months ended June 30, 2009 and 2008 are as follows:

	Early Development	Late-Stage Development	Other Reconciling Items	Total
Three months ended June 30, 2009				
Total revenues from external customers	$ 199,767	$ 266,282	$ 23,226(a)	$ 489,275
Operating income	$ 27,083	$ 65,521	$ (32,607)(b)	$ 59,997
Total assets	$ 1,184,412	$ 547,756	$ 134,928(c)	$ 1,867,096
Three months ended June 30, 2008				
Total revenues from external customers	$ 213,119	$ 223,793	$ 24,911(a)	$ 461,823
Operating income	$ 54,220	$ 43,004	$ (29,769)(b)	$ 67,455
Total assets	$ 1,044,026	$ 469,261	$ 77,252(c)	$ 1,590,539
Six months ended June 30, 2009				
Total revenues from external customers	$ 392,272	$ 515,013	$ 50,447(a)	$ 957,732
Operating income	$ 54,243	$ 121,849	$ (60,152)(b)	$ 115,940
Total assets	$ 1,184,412	$ 547,756	$ 134,928(c)	$ 1,867,096
Six months ended June 30, 2008				
Total revenues from external customers	$ 415,164	$ 434,180	$ 46,516(a)	$ 895,860
Operating income	$ 104,794	$ 81,874	$ (56,476)(b)	$ 130,192
Total assets	$ 1,044,026	$ 469,261	$ 77,252(c)	$ 1,590,539

(a) Represents revenues associated with reimbursable out-of-pocket expenses.

(b) Represents corporate expenses (primarily information technology, marketing, communications, human resources, finance, legal and stock-based compensation expense).

(c) Represents corporate assets.

10. Subsequent Events

On July 15, 2009, Covance entered into an agreement to sell its Interactive Voice & Web Response (IVR) service offering, part of Covance s late-stage development segment, to Phase Forward for cash. In addition, Covance and Phase Forward have agreed to enter into a multi-year marketing agreement to provide Phase Forward s electronic data capture solutions and IVR services to Covance s clients for the next five years. Covance expects the sale, which is subject to certain closing conditions, to be completed during the third quarter of 2009.

On July 29, 2009, Covance announced it entered into an agreement with Merck & Co., Inc. (Merck) to acquire for cash, the assets and capabilities of Merck s Gene Expression Laboratory (GEL) located in Seattle, Washington. GEL performs genomics services such as genotyping, gene sequencing and gene expression profiling. In addition, Covance and Merck have agreed to enter into an agreement pursuant to which Merck will exclusively purchase at least $145 million of genomic analysis services from Covance over a 5-year period. This agreement will expand Covance s footprint in the genomics testing market. Covance expects to complete this transaction and assume responsibility for the operations in the third quarter of 2009, at which time the cash consideration will be paid.

Covance completed an evaluation of the impact of any other subsequent events through August 4, 2009, the date these financial statements were issued, and determined there were no other subsequent events requiring disclosure in or adjustment to these financial statements.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion together with the unaudited Covance consolidated financial statements and the accompanying notes included in this Quarterly Report on Form 10-Q for the quarter ended June 30, 2009.

Overview

Covance is a leading drug development services company providing a wide range of early-stage and late-stage product development services on a worldwide basis primarily to the pharmaceutical, biotechnology and medical device industries. Covance also provides services such as laboratory testing to the chemical, agrochemical and food industries. The foregoing services comprise two reportable segments for financial reporting purposes: early development services, which includes preclinical and clinical pharmacology service offerings; and late-stage development services, which includes central laboratory, clinical development, periapproval and market access services. Although each segment has separate services within it, they can be combined in joint service offerings and we believe clients increasingly are interested in opportunities for such combined services. Covance believes it is one of the largest drug development services companies, based on annual net revenues, and one of a few that is capable of providing comprehensive global product development services. Covance offers its clients high quality services designed to provide data to clients as rapidly as possible and reduce product development time. We believe this enables Covance s customers to introduce their products into the marketplace faster and as a result, maximize the period of market exclusivity and monetary return on their research and development investments. Additionally, Covance s comprehensive services and broad experience provide its customers with a variable cost alternative to fixed cost internal development capabilities.

Critical Accounting Policies

Covance s consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP), which require management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from these estimates. The following discussion highlights what we believe to be the critical accounting policies and judgments made in the preparation of these consolidated financial statements.

Revenue Recognition. Covance recognizes revenue either as services are performed or products are delivered, depending on the nature of the work contracted. Historically, a majority of Covance s net revenues have been earned under contracts which range in duration from a few months to two years, but can extend in duration up to five years or longer. We also have dedicated capacity arrangements with certain clients ranging in duration from one to ten years. Underlying these arrangements are individual project contracts for the specific services to be provided. Dedicated capacity arrangements enable our clients to secure space in our facilities in exchange for which they agree to provide a guaranteed annual minimum dollar value (volume) of work. Under these types of arrangements, if the annual minimum volume commitment is not reached, the client is required to pay Covance for the shortfall. Progress towards the achievement of annual minimum volume guarantees is monitored throughout the year. Annual minimum guarantee shortfalls are included in net revenues when the amount of the shortfall is determinable and realization is assured.

We do not have any individual significant contracts as pertains to revenue recognition. By way of background, at any point in time we are working on thousands of active clients projects, which are governed by individual contracts. In addition, we have not had a single customer who accounted for more than ten percent of our aggregate net revenues during any one of the last three years. We serve in excess of 300 biopharmaceutical companies and we have over 8,000 active client projects. Most projects are customized based on the needs of the client, the type of services being provided, therapeutic indication of the drug, geographic locations and other variables. Project specific terms related to pricing, billing milestones and the scope and type of services to be provided are generally negotiated and contracted on a project-by-project basis.

Service contracts generally take the form of fee-for-service or fixed-price arrangements. In cases where performance spans multiple accounting periods, revenue is recognized as services are performed, measured on a proportional-performance basis, generally using output measures that are specific to the service provided. Examples of output measures in our early development segment include the number of slides read, dosings performed, or specimens prepared for preclinical laboratory services, or number of dosings or number of volunteers enrolled for clinical pharmacology. Examples of output measures in our late-stage development segment s clinical development service offering include among others, number of investigators enrolled, number of sites initiated, number of patients enrolled and number of monitoring visits completed. Revenue is determined by

Table of Contents

dividing the actual units of work completed by the total units of work required under the contract and multiplying that percentage by the total contract value. The total contract value, or total contractual payments, represents the aggregate contracted price for each of the agreed upon services to be provided. We do not have any contractual arrangements spanning multiple accounting periods where revenue is recognized on a proportional-performance basis under which we have earned more than an immaterial amount of performance-based revenue (i.e. potential additional revenue tied to specific deliverables or performance). Changes in the scope of work are common, especially under long-term contracts, and generally result in a change in contract value. Once the client has agreed to the changes in scope and renegotiated pricing terms, the contract value is amended and revenue is recognized as described above. Estimates of costs to complete are made to provide, where appropriate, for losses expected on contracts. Costs are not deferred in anticipation of contracts being awarded, but instead are expensed as incurred. For the quarter ended June 30, 2009, we did not experience a change in the estimates used to determine the amounts recognized as revenue (i.e. output measures or costs to complete) for any project resulting in a material impact on our financial position, results of operations or cash flows.

Billing schedules and payment terms are generally negotiated on a contract-by-contract basis. In some cases, we bill the client for the total contract value in progress-based installments as we reach certain non-contingent billing milestones over the contract duration, such as, but not limited to, contract signing, initial dosing, investigator site initiation, patient enrollment or database lock. The term billing milestone relates only to a billing trigger in a contract whereby amounts become billable and payable in accordance with a negotiated predetermined billing schedule throughout the term of a project. These billing milestones are not performance-based (i.e., potential additional arrangement consideration tied to specific deliverables or performance). In other cases, billing and payment terms are tied to the passage of time (e.g., monthly billings). In either case, the total contract value and aggregate amounts billed to the client would be the same at the end of the project. While we attempt to negotiate terms that provide for billing and payment of services prior to or within close proximity to the provision of services, this is not always the case, as evidenced by fluctuations in the levels of unbilled receivables and unearned revenue from period to period. While a project is ongoing, cash payments are not necessarily representative of aggregate revenue earned at any particular point in time, as revenues are recognized when services are provided, while amounts billed and paid are in accordance with the negotiated billing and payment terms.

In some cases, payments received are in excess of revenue recognized. For example, a contract invoicing schedule may provide for an upfront payment of 10% of the full contract value upon contract signing, but at the time of signing, performance of services has not yet begun, and therefore, no revenue has yet been recognized. Payments received in advance of services being provided, such as in this example, are deferred as unearned revenue on the balance sheet. As the contracted services are subsequently performed and the associated revenue is recognized, the unearned revenue balance is reduced by the amount of revenue recognized during the period.

In other cases, services may be provided and revenue is recognized before we have invoiced the client. In these cases, revenue recognized will exceed amounts billed, and the difference, representing an unbilled receivable, is recorded for this amount that is currently unbillable to the customer pursuant to contractual terms. Once we have invoiced the client, the unbilled receivable is reduced for the amount billed, and a corresponding account receivable is recorded. All unbilled receivables are billable to customers within one year from the respective balance sheet date.

Most contracts are terminable by the client either immediately or upon notice. These contracts typically require payment to Covance of expenses to wind down the study, fees earned to date and, in some cases, a termination fee or a payment to Covance of some portion of the fees or profits that could have been earned by Covance under the contract if it had not been terminated early. Termination fees are included in net revenues when realization is assured.

Bad Debts. Covance endeavors to assess and monitor the creditworthiness of its customers to which it grants credit terms in the ordinary course of business. Covance maintains a provision for doubtful accounts relating to amounts due that may not be collected. This bad debt provision is monitored on a monthly basis and adjusted as circumstances warrant. Since the recorded bad debt provision is based upon management s

judgment, actual bad debt write-offs may be greater or less than the amount recorded. Historically bad debt write-offs have not been material.

Taxes. Since Covance conducts operations on a global basis, its effective tax rate has and will continue to depend upon the geographic distribution of its pre-tax earnings among locations with varying tax rates. Covance s profits are further impacted by changes in the tax rates of the various jurisdictions in which Covance operates. In addition, Covance maintains a reserve for unrecognized tax benefits, changes to which could impact Covance s effective tax rate in the period such changes are made.

Table of Contents

The Company accounts for uncertain income tax positions in accordance with the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). Under the guidance of FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not to be sustained upon examination based on the technical merits of the position. The amount of the accrual for which an exposure exists is measured as the largest amount of benefit determined on a cumulative probability basis that the Company believes is more likely than not to be realized upon ultimate settlement of the position. Components of the reserve are classified as either a current or long-term liability in the consolidated balance sheet based on when the Company expects each of the items to be settled. Covance records interest and penalties accrued in relation to unrecognized tax benefits as a component of income tax expense.

As of June 30, 2009, the balance of the reserve for unrecognized tax benefits was $12.3 million, including accrued interest of $1.6 million, of which $3.4 million is recorded as a current liability in accrued expenses and other current liabilities, and $8.9 million is recorded as a long-term liability in other liabilities on the consolidated balance sheet. This reserve relates to exposures for income tax matters such as transfer pricing, nexus, deemed income and research and development credits.

The Company also maintains a tax reserve related to exposures for non-income tax matters including value-added tax and state sales and use and other taxes, which are accounted for in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. The balance of this reserve at June 30, 2009 is $0.9 million and is recorded as a current liability in accrued expenses and other current liabilities on the consolidated balance sheet.

While Covance believes that it has identified all reasonably identifiable exposures and that the reserve it has established for identifiable exposures is appropriate under the circumstances, it is possible that additional exposures exist and that exposures will be settled at amounts different than the amounts reserved. It is also possible that changes in facts and circumstances could cause Covance to either materially increase or reduce the carrying amount of its tax reserve.

Covance s policy is to provide income taxes on earnings of foreign subsidiaries only to the extent those earnings are taxable or are expected to be remitted. Covance s historical policy has been to leave its unremitted foreign earnings invested indefinitely outside the United States. Covance intends to continue to leave its unremitted foreign earnings invested indefinitely outside the United States. As a result, taxes have not been provided on any of the remaining accumulated foreign unremitted earnings as of June 30, 2009.

Stock-Based Compensation. The Company sponsors several stock-based compensation plans pursuant to which non-qualified stock options and restricted stock awards are granted to eligible employees. These plans are described more fully in Note 10 to our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008 and Note 8 to our consolidated financial statements in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 included elsewhere herein.

The Company recognizes stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payments*, (SFAS 123R), pursuant to which the grant-date fair value of awards expected to vest is expensed on a straight-line basis over the vesting period of the related awards. The grant-date fair value of stock awards is based upon the underlying price of the stock on the date of grant. The grant-date fair value of stock option awards must be determined using an option pricing model. Option pricing models require the use of estimates and assumptions as to (a) the expected term of the option, (b) the expected volatility of the price of the underlying stock, (c) the risk-free interest rate for the expected term of the option and (d) pre-vesting forfeiture rates.

The expected term of the option is based upon the contractual term and expected employee exercise and expected post-vesting employment termination behavior. The expected volatility of the price of the underlying stock is based upon the volatility of the Company s stock computed over a period of time equal to the expected term of the option. The risk free interest rate is based upon the implied yields currently available from the U.S. Treasury zero-coupon yield curve for issues with a remaining duration equal to the expected term of the option. Pre-vesting forfeiture rates are estimated based upon past voluntary termination behavior and past option forfeitures.

The following table sets forth the weighted-average assumptions used to calculate the fair value of options granted for the three and six month periods ended June 30, 2009 and 2008:

Table of Contents

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Expected stock price volatility	36%	39%	36%	39%
Risk free interest rate(s)	0.3% - 2.6%	1.9% - 3.7%	0.3% - 2.6%	1.9% - 3.7%
Expected life of options (years)	4.6	4.4	4.6	4.4

Changes in any of these assumptions could impact, potentially materially, the amount of expense recorded in future periods related to stock-based awards.

Impairment of Assets. Covance reviews its long-lived assets other than goodwill and other indefinite lived intangible assets for impairment, when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. The assessment of possible impairment is based upon Covance s judgment of its ability to recover the asset from the expected future undiscounted cash flows of the related operations. Actual future cash flows may be greater or less than estimated.

Covance performs an annual test for impairment of goodwill and other indefinite lived intangible assets during the fourth quarter. This test is performed by comparing, at the reporting unit level, the carrying value of the reporting unit to its fair value. Covance assesses fair value based upon its estimate of the present value of the future cash flows that it expects to be generated by the reporting unit. The most recent test for impairment performed for 2008 did not identify any instances of impairment and there were no events through June 30, 2009 that warranted a reconsideration of our impairment test results. However, changes in expectations as to the present value of the reporting unit s future cash flows might impact subsequent years assessments of impairment.

Defined Benefit Pension Plans. Covance sponsors defined benefit pension plans for the benefit of its employees at three foreign subsidiaries, as well as a non-qualified supplemental executive retirement plan and a post-employment retiree health and welfare plan for the benefit of eligible employees at certain U.S. subsidiaries. The measurement of the related benefit obligation and net periodic benefit cost recorded each year is based upon actuarial computations, which require the use of judgment as to certain assumptions. The more significant of these assumptions are: (a) the appropriate discount rate to use in computing the present value of the benefit obligation; (b) the expected return on plan assets (for funded plans); and (c) the expected future rate of salary increases (for pay-related plans). Actual results (such as the return on plan assets, future rate of salary increases and plan participation rates) will likely differ from the assumptions used. Those differences, along with changes that may be made in the assumptions used from period to period, will impact the amounts reported in the financial statements and footnote disclosures.

Set forth below is a discussion of the impact that (a) differences between assumed results and actual results and (b) assumption changes have had on our results of operations for the years ended December 31, 2008, 2007 and 2006 and on the financial position of the plans as of December 31, 2008 and 2007 for our United Kingdom defined benefit pension plans (the largest of our defined benefit-type pension plans).

	United Kingdom Plans			
(amounts in millions)	2008	2007	2006	2005
Net periodic pension cost	$ 3.4	$ 4.0	$ 4.6	$ 4.1
Weighted average assumptions used to determine net periodic pension cost:				
Discount rate	5.50%	5.25%	5.00%	5.75%
Expected rate of return on assets	6.75%	6.75%	6.75%	6.75%
Salary increases	4.25%	4.00%	4.00%	4.00%

Table of Contents

The increase (decrease) in the net periodic benefit cost from period to period is attributable to the following:

	United Kingdom Plans		
(amounts in millions)	**2007 to 2008**	**2006 to 2007**	**2005 to 2006**
Change in discount rate	$ (1.1)	$ (1.3)	$ 2.4
Change in rate of salary increases	(0.1)		
Other, including differences between actual experience and assumptions used	0.9	0.3	(1.9)
Foreign currency exchange rate changes	(0.3)	0.4	
Net change in periodic benefit cost	$ (0.6)	$ (0.6)	$ 0.5
Weighted average assumptions used to determine benefit obligation:			
Discount rate	6.25%	5.50%	5.25%
Salary increases	4.25%	4.25%	4.00%

The change in the projected benefit obligation from period to period is attributable to the following:

	United Kingdom Plans	
(amounts in millions)	**2007 to 2008**	**2006 to 2007**
Projected benefit obligation, beginning of year	$ 152.1	$ 141.3
Service/interest cost components of net periodic benefit cost in year	13.1	13.5
Benefits paid	(1.7)	(2.1)
Actuarial gain (loss):		
Increase in discount rate	(23.5)	(8.5)
Other, including differences between actual experience and assumptions used	8.1	6.3
Foreign currency exchange rate changes	(36.2)	1.6
Projected benefit obligation, end of year	$ 111.9	$ 152.1

Foreign Currency Risks

Since Covance operates on a global basis, it is exposed to various foreign currency risks. Two specific risks arise from the nature of certain contracts. The first risk can occur when Covance executes contracts with its customers where the contracts are denominated in a currency different than the local currencies of the Covance subsidiaries performing work under the contracts. As a result, revenue recognized for services rendered may be denominated in a currency different from the currencies in which the subsidiaries expenses are incurred. Fluctuations in exchange rates (from those in effect at the time the contract is executed and pricing is established to the time services are rendered and revenue is recognized) can affect the subsidiary s net revenues and resultant earnings. This risk is generally applicable only to a portion of the contracts executed by Covance s subsidiaries providing clinical services. Historically, fluctuations in exchange rates from those in effect at the time contracts were executed have not had a material effect upon Covance s consolidated financial results. See Risk Factors .

We also have other cross-currency contracts executed by other Covance subsidiaries where the foreign currency amounts billed are determined by converting local currency revenue amounts to the contract billing currency using the exchange rates in effect at the time services are rendered. These contracts do not give rise to foreign currency denominated revenue and local currency denominated expenses, but they do give rise to a second type of risk. This second type of risk results from the passage of time between the invoicing of customers under both of these types of contracts and the ultimate collection of customer payments against such invoices. Because such invoices are denominated in a currency other than the subsidiary s local currency, Covance recognizes a receivable at the time of invoicing for the local currency equivalent of the

foreign currency invoice amount as of the invoice date. Subsequent changes in exchange rates from the time the invoice is prepared to the time payment from the customer is received will result in Covance receiving either more or less in local currency than the local currency

Table of Contents

equivalent of the invoice amount at the time the invoice was prepared and the receivable was recorded. This difference is recognized by Covance as a foreign currency transaction gain or loss, as applicable, in the consolidated statements of income.

Finally, Covance s consolidated financial statements are denominated in U.S. dollars. Accordingly, changes in exchange rates between the applicable foreign currency and the U.S. dollar will affect the translation of each foreign subsidiary s financial results into U.S. dollars for purposes of reporting Covance s consolidated financial results. The process by which each foreign subsidiary s financial results are translated into U.S. dollars is as follows: income statement accounts are translated at average exchange rates for the period; balance sheet asset and liability accounts are translated at end of period exchange rates; and equity accounts are translated at historical exchange rates. Translation of the balance sheet in this manner affects the stockholders equity account, referred to as the cumulative translation adjustment account. This account exists only in the foreign subsidiary s U.S. dollar balance sheet and is necessary to keep the foreign balance sheet stated in U.S. dollars in balance. At June 30, 2009, accumulated other comprehensive income on the consolidated balance sheet includes the cumulative translation account balance of $20.4 million.

Operating Expenses and Reimbursable Out-of-Pockets

Covance segregates its recurring operating expenses among four categories: cost of revenue; reimbursable out-of-pocket expenses; selling, general and administrative expenses; and depreciation and amortization. Cost of revenue includes direct labor and related benefits, other direct costs, shipping and handling fees, and an allocation of facility charges and information technology costs, and excludes depreciation and amortization. Cost of revenue, as a percentage of net revenues, tends and is expected to fluctuate from one period to another, as a result of changes in labor utilization and the mix of service offerings involving hundreds of studies conducted during any period of time. Selling, general and administrative expenses consist primarily of administrative payroll and related benefit charges, advertising and promotional expenses, administrative travel and an allocation of facility charges and information technology costs, and excludes depreciation and amortization.

In connection with the management of multi-site clinical trials, Covance pays on behalf of its customers fees to investigators, volunteers and other out-of-pocket costs (such as for travel, printing, meetings, couriers, etc.), for which it is reimbursed at cost, without mark-up or profit. Investigator fees are not reflected in total revenues or expenses where Covance acts in the capacity of an agent on behalf of the pharmaceutical company sponsor, passing through these costs without risk or reward to Covance. All other out-of-pocket costs are included in total revenues and expenses.

Quarterly Results

Covance s quarterly operating results are subject to variation, and are expected to continue to be subject to variation, as a result of factors such as (1) delays in initiating or completing significant drug development trials, (2) termination or reduction in size of drug development trials, (3) acquisitions and divestitures, (4) changes in the mix of our services, and (5) exchange rate fluctuations. Delays and terminations of trials are often the result of actions taken by Covance s customers or regulatory authorities and are not typically controllable by Covance. Since a large amount of Covance s operating costs are relatively fixed while revenue is subject to fluctuation, moderate variations in the commencement, progress or completion of drug development trials may cause significant variations in quarterly results.

Results of Operations

Three Months Ended June 30, 2009 Compared with Three Months Ended June 30, 2008. Net revenues totaling $466.0 million for the three months ended June 30, 2009 increased 6.7%, or 13.1% excluding the unfavorable impact of foreign exchange rate variances between both periods, as compared to $436.9 million for the corresponding 2008 period. Net revenues from Covance s early development segment declined 6.3%, or 0.9% excluding the unfavorable impact of foreign exchange rate variances between both periods. Softness in the early development segment was driven by a 9.7% decrease in net revenues in our preclinical laboratory services, resulting from continued lower market demand from our biopharmaceutical clients across many of our service offerings. Net revenues from Covance s late-stage development segment grew 19.0%, or 26.4% excluding the unfavorable impact of foreign exchange rate variances between both periods. Growth was broad based across the late-stage development segment, led by continued strong performance in our central laboratory services, where net revenues grew 24.2% on increased investigator and patient enrollment and an overall higher level of study activity. Also driving growth in the late-stage development segment was continued strong performance in our clinical development services, where net revenues grew 9.7% on increased study activity.

Table of Contents

Cost of revenue increased 9.2% to $313.2 million or 67.2% of net revenues for the three months ended June 30, 2009 as compared to $286.9 million or 65.7% of net revenues for the corresponding 2008 period. Gross margins decreased by 150 basis points to 32.8% for the three months ended June 30, 2009 from 34.3% for the corresponding 2008 period as softness in pre-clinical laboratory services net revenues more than offset strength in net revenues from our other service offerings.

Overall, selling, general and administrative expenses increased 6.6% to $69.6 million for the three months ended June 30, 2009 from $65.2 million for the corresponding 2008 period. As a percentage of net revenues, selling, general and administrative expenses was 14.9% for each of the three month periods ended June 30, 2009 and 2008.

Depreciation and amortization increased 34.3% to $23.3 million or 5.0% of net revenues for the three months ended June 30, 2009 from $17.3 million or 4.0% of net revenues for the corresponding 2008 period as a result of the commencement of depreciation of assets placed into service late in the first quarter of 2009 upon the completion of several large facility construction projects and generally higher levels of capital spending related to other assets placed into service over the last year.

Income from operations decreased 11.1% to $60.0 million or 12.9% of net revenues for the three months ended June 30, 2009 from $67.5 million or 15.4% of net revenues for the corresponding 2008 period.

Income from operations from Covance s early development segment for the three months ended June 30, 2009 decreased 50.0% or $27.1 million to $27.1 million as compared to $54.2 million for the corresponding 2008 period. As a percentage of net revenues, early development income from operations declined from 25.4% of net revenues in the three months ended June 30, 2008 to 13.6% in the corresponding 2009 period. The softness in pre-clinical net revenues in the three month period ended June 30, 2009 explained above coupled with the unfavorable impact of foreign exchange rate variances as compared to the prior year period drove $20.7 million of the reduction in operating income. Additionally, comparability between periods was impacted by costs incurred in connection with the following activities in the three month period ended June 30, 2009: the staffing and validation of our new pre-clinical facility in Chandler, Arizona which opened in late March 2009; severance costs incurred in connection with the retirement of one of the oldest buildings at our pre-clinical site in Vienna, Virginia; and the launch and growth of our service offerings at the Greenfield, Indiana site purchased from Eli Lilly in the fourth quarter of 2008

Income from operations from Covance s late-stage development segment for the three months ended June 30, 2009 increased 52.4% or $22.5 million to $65.5 million as compared to $43.0 million for the corresponding 2008 period. Excluding the unfavorable impact of foreign exchange rate variances between both periods, late-stage development income from operations increased 61.5% or $26.4 million as compared to the corresponding 2008 period. As a percentage of net revenues, late-stage development income from operations increased 540 basis points from 19.2% of net revenues in the three month period ended June 30, 2008 to 24.6% of net revenues in the corresponding 2009 period, driven by strength in central laboratory and clinical development revenues explained above, coupled with increased efficiency gained from leveraging existing support functions across a larger base of revenues.

Corporate expense increased $2.8 million to $32.6 million for the three months ended June 30, 2009 as compared to $29.8 million for the corresponding 2008 period. As a percentage of net revenues, Corporate expense increased by 20 basis points from 6.8% of net revenues for the three month period ended June 30, 2008 to 7.0% of net revenues for the corresponding 2009 period. Included in Corporate expense is stock-based compensation expense of 7.4 million or 1.6% of net revenues for the three months ended June 30, 2009, as compared to $6.5 million or 1.5% of net revenues for the corresponding 2008 period.

Other income and expense, net decreased $3.7 million to net expense of $0.7 million for the three months ended June 30, 2009 as compared to other income of $2.9 million for the corresponding 2008 period. Interest income decreased $1.7 million as compared to the prior year period due to lower interest rates on lower invested cash balances. Net foreign exchange transaction losses were $1.2 million during the 2009 period as compared to net foreign exchange transaction gains of $0.5 million in the corresponding 2008 period.

Covance s effective tax rate for the three months ended June 30, 2009 was 27.1% compared to 28.9% for the corresponding 2008 period. The year-over-year decrease in Covance s effective tax rate is attributable to a number of factors, including the mix of our pre-tax earnings across various tax jurisdictions and tax planning initiatives.

Covance has a 47% minority equity position in Noveprim Limited (Noveprim), a supplier of research products. For the three month period ended June 30, 2009, Covance recognized a loss of $0.2 million, representing its share of Noveprim s losses, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2009. For

Table of Contents

the three month period ended June 30, 2008, Covance recognized income of $0.7 million, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2008.

Covance has a minority equity position (less than 20%) in BioClinica, Inc. (BIOC), formerly known as Bio Imaging Technologies, Inc. BIOC uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. During the three month period ended June 30, 2008, Covance recognized income of $0.1 million representing its pro rata share of BIOC s earnings. In the fourth quarter of 2008, Covance suspended the use of the equity method of accounting for its investment in BIOC as its ownership interest fell below 20% and it could no longer exercise significant influence over BIOC s operations. In the fourth quarter of 2008, Covance began accounting for its investment in BIOC as an available-for-sale security in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). Accordingly, Covance no longer records in equity earnings its pro-rata share of BIOC results but rather, reflects the fair value of its investment in BIOC on its consolidated balance sheet. See Note 4 to the unaudited consolidated financial statements included elsewhere in this quarterly report.

Net income of $43.0 million for the three months ended June 30, 2009 decreased $7.9 million or 15.5% as compared to $50.9 million for the corresponding 2008 period.

Six Months Ended June 30, 2009 Compared with Six Months Ended June 30, 2008. Net revenues totaling $907.3 million for the six months ended June 30, 2009 increased 6.8%, or 13.4% excluding the unfavorable impact of foreign exchange rate variances between both periods, as compared to $849.3 million for the corresponding 2008 period. Net revenues from Covance s early development segment decreased 5.5%, but increased 0.5% excluding the unfavorable impact of foreign exchange rate variances between both periods. Softness in the early development segment was driven by a 6.7% decrease in net revenues in our preclinical laboratory services, resulting from lower market demand from our biopharmaceutical clients across many of our service offerings. Net revenues from Covance s late-stage development segment grew 18.6%, or 25.8% excluding the unfavorable impact of foreign exchange rate variances between both periods. Growth was broad based across the late-stage development segment, led by strong performance in our central laboratory services, where net revenues grew 24.4% on increased investigator and patient enrollment and overall higher level of study activity. Also driving growth in the late-stage development segment was a strong performance in our clinical development services, where net revenues grew 9.3% on increased study activity.

Cost of revenue increased 9.8% to $614.9 million or 67.8% of net revenues for the six months ended June 30, 2009 as compared to $560.2 million or 66.0% of net revenues for the corresponding 2008 period. Gross margins decreased by 180 basis points to 32.2% for the six months ended June 30, 2009 from 34.0% for the corresponding 2008 period as softness in pre-clinical laboratory services net revenues more than offset strength in late-stage development services net revenues.

Overall, selling, general and administrative expenses increased 7.5% to $133.5 million for the six months ended June 30, 2009 from $124.3 million for the corresponding 2008 period. As a percentage of net revenues, selling, general and administrative expenses increased

slightly by 10 basis points to 14.7% for the six month period ended June 30, 2009 from 14.6% for the corresponding 2008 period. Selling, general and administrative expenses as a percentage of net revenues can and does vary depending on the timing and nature of various professional fees and other discretionary spending.

Depreciation and amortization increased 23.7% to $42.9 million or 4.7% of net revenues for the six months ended June 30, 2009 from $34.7 million or 4.1% of net revenues for the corresponding 2008 period as a result of the commencement of depreciation of assets placed into service late in the first quarter of 2009 upon the completion of several large facility construction projects and generally higher levels of capital spending related to other assets placed into service over the last year.

Income from operations decreased 10.9% to $115.9 million or 12.8% of net revenues for the six months ended June 30, 2009 from $130.2 million or 15.3% of net revenues for the corresponding 2008 period.

Income from operations from Covance s early development segment for the six months ended June 30, 2009 decreased 48.2% or $50.6 million to $54.2 million as compared to $104.8 million for the corresponding 2008 period. As a percentage of net revenues, early development income from operations declined from 25.2% of net revenues in the six months ended June 30, 2008 to 13.8% in the corresponding 2009 period, driven by softness in pre-clinical net revenues in the six month period ended June 30, 2009 explained above. Additionally, comparability between periods was impacted by costs incurred in connection with the following activities in the six month period ended June 30, 2009: the staffing and validation of our new pre-clinical facility

Table of Contents

in Chandler, Arizona which opened in late March 2009; costs incurred to close two of our small clinical pharmacology sites; severance costs incurred in connection with the retirement of one of the oldest buildings at our pre-clinical site in Vienna, Virginia; and the launch and growth of our service offerings at the Greenfield, Indiana site purchased from Eli Lilly in the fourth quarter of 2008.

Income from operations from Covance s late-stage development segment for the six months ended June 30, 2009 increased 48.8% or $40.0 million to $121.8 million as compared to $81.9 million for the corresponding 2008 period. As a percentage of net revenues, late-stage development income from operations increased 480 basis points from 18.9% of net revenues in the six month period ended June 30, 2008 to 23.7% of net revenues in the corresponding 2009 period. The strength in central laboratory and clinical development revenues explained above, coupled with increased efficiency gained from leveraging existing support functions across a larger base of revenues, drove $34.3 million of the $40.0 million increase in operating income. The remainder of the increase was due to revenue growth in all other service lines in the segment.

Corporate expense increased $3.7 million to $60.2 million for the six months ended June 30, 2009 as compared to $56.5 million for the corresponding 2008 period. As a percentage of net revenues, Corporate expense was 6.6% of net revenues for each of the six month periods ended June 30, 2009 and 2008. Included in Corporate expense is stock-based compensation expense of $13.2 million or 1.5% of net revenues for the six months ended June 30, 2009, as compared to $12.6 million or 1.5% of net revenues for the corresponding 2008 period.

Other income and expense, net decreased $9.8 million to net expense of $0.2 million for the six months ended June 30, 2009 as compared to other income of $9.6 million for the corresponding 2008 period. Interest income decreased $4.1 million as compared to the prior year period due to lower interest rates on lower invested cash balances. Gains from the receipt of contingent consideration on transferred backlog on the November 2007 sale of Covance s cardiac safety service offering were $3.3 million lower as compared to the prior year period. Net foreign exchange transaction losses were $0.8 million during the 2009 period as compared to net foreign exchange transaction gains of $1.5 million for the corresponding 2008 period.

Covance s effective tax rate for the six months ended June 30, 2009 was 28.0% compared to 29.4% for the corresponding 2008 period. The year-over-year decrease in Covance s effective tax rate is attributable to a number of factors, including the mix of our pre-tax earnings across various tax jurisdictions and tax planning initiatives.

Covance has a 47% minority equity position in Noveprim Limited (Noveprim), a supplier of research products. For the six month period ended June 30, 2009, Covance recognized a loss of $0.04 million representing its share of Noveprim s losses, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2009. For the six month period ended June 30, 2008, Covance recognized income of $1.0 million representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at June 30, 2008.

Covance has a minority equity position (less than 20%) in BioClinica, Inc. (BIOC), formerly known as Bio Imaging Technologies, Inc. BIOC uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. During the six month period ended June 30, 2008, Covance recognized income of $0.3 million representing its pro rata share of BIOC s earnings. In the fourth quarter of 2008, Covance suspended the use of the equity method of accounting for its investment in BIOC as its ownership interest fell below 20% and it could no longer exercise significant influence over BIOC s operations. In the fourth quarter of 2008, Covance began accounting for its

investment in BIOC as an available-for-sale security in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). Accordingly, Covance no longer records in equity earnings its pro-rata share of BIOC results but rather, reflects the fair value of its investment in BIOC on its consolidated balance sheet. See Note 4 to the unaudited consolidated financial statements included elsewhere in this quarterly report.

Net income of $83.3 million for the six months ended June 30, 2009 decreased $16.7 million or 16.7% as compared to $100.0 million for the corresponding 2008 period.

Table of Contents

Liquidity and Capital Resources

Cash and cash equivalents at June 30, 2009 and December 31, 2008 were $204.4 million and $221.3 million, respectively. Amounts are principally invested in short-term money market funds and bank deposits with major financial institutions in countries whose governments guarantee those investments (primarily in Ireland and the United Kingdom). Covance s expected primary cash needs on both a short and long-term basis are for capital expenditures, expansion of services, possible future acquisitions, geographic expansion, working capital and other general corporate purposes, including possible share repurchases. On June 16, 2009, Covance entered into a new $150.0 million revolving credit facility which replaced its credit facility which was due to expire on June 30, 2009. The Credit Facility may be expanded to $200.0 million at Covance s election. Covance believes cash on hand plus cash from operations and available borrowings under its revolving credit facility will provide sufficient liquidity for the foreseeable future. At June 30, 2009, there were $58.0 million of outstanding borrowings and $1.4 million of outstanding letters of credit under the credit facility. Interest on all outstanding borrowings under the new credit facility is based upon the London Interbank Offered Rate (LIBOR) plus a 200 basis point margin. Interest under the previous credit facility was based on LIBOR plus a 75 basis point margin. Interest on outstanding borrowings during the six months ended June 30, 2009 approximated 1.33% per annum. Costs associated with the new credit facility, which expires in June 2012, consisted primarily of bank and legal fees totaling $0.9 million which will be amortized over the three year facility term. The new credit facility contains various financial and other covenants. At June 30, 2009, Covance was in compliance with the terms of the new credit facility. The new credit facility is collateralized by guarantees of certain of Covance s domestic subsidiaries and a pledge of 65 percent of the capital stock of certain of Covance s foreign subsidiaries.

During the six months ended June 30, 2009, Covance s operations provided net cash of $58.6 million, a decrease of $27.2 million from the corresponding 2008 period. The change in net operating assets used $79.0 million in cash during the six months ended June 30, 2009, primarily due to an increase in accounts receivable and a decrease in accrued incentive compensation. The change in net operating assets used $54.1 million in cash during the six months ended June 30, 2008, primarily due to an increase in unbilled services, accounts receivable and inventory and a decrease in accrued incentive compensation and accounts payable, partially offset by an increase in other accrued expenses. Covance s ratio of current assets to current liabilities was 1.73 at June 30, 2009 and 1.60 at December 31, 2008.

Investing activities for the six months ended June 30, 2009 used $88.9 million, compared to using $139.1 million for the corresponding 2008 period. Capital spending for the first six months of 2009 totaled $70.9 million, and was primarily for the expansion of preclinical facilities in North America and Europe, outfitting of new facilities, upgrade of existing equipment, and the purchase of new equipment, hardware and software. Approximately $36.2 million of capital spending in the first six months of 2009 represents expenditures primarily related to ongoing significant facility expansions and transformational information technology projects that were not placed in service at June 30, 2009. Capital spending for the corresponding 2008 period totaled $143.2 million, and was primarily for the expansion of preclinical facilities in North America and Europe, outfitting of new facilities, upgrade of existing equipment, and the purchase of new equipment, hardware and software.

Investing activities for the six months ended June 30, 2009 also include Covance s acquisition in March 2009 of 100% of the stock of Swiss Pharma Contract Ltd. (Swiss Pharma), and its 50-bed clinical research facility based in Basel, Switzerland, for cash payments aggregating $19.4 million ($18.6 million net of cash acquired). Transaction related costs of $0.5 million were reported as selling, general and administrative expense in the six month period ended June 30, 2009. This acquisition expanded Covance s clinical pharmacology presence in Europe and provides access to special patient populations for Phase I/IIa clinical studies. Swiss Pharma s assets and liabilities acquired were included in Covance s consolidated balance sheet at March 31, 2009 based on their estimated fair value of $2.8 million on a net basis, as determined by a preliminary purchase price allocation. Intangible assets acquired were valued at $1.8 million. The remaining purchase price of $18.2 million represents goodwill. In addition to the initial cash consideration of $19.4 million, Covance accrued a liability of $3.4 million for the estimated fair value of future contingent consideration expected to be payable by Covance based upon Swiss Pharma reaching specific performance metrics over the next three years of operation. Swiss Pharma is expected to be accretive to earnings in 2009. Results of operations for Swiss Pharma are reported in Covance s early development segment. See Note 5 to the unaudited consolidated financial statements included elsewhere in this quarterly report.

On July 29, 2009, Covance announced it entered into an agreement with Merck & Co., Inc. (Merck) to acquire for cash, the assets and capabilities of Merck s Gene Expression Laboratory (GEL) located in Seattle, Washington. GEL performs genomics services such as genotyping, gene sequencing and gene expression profiling. In addition, Covance and Merck have agreed to enter into an agreement pursuant to which Merck will exclusively purchase at least $145 million of genomic analysis services from Covance over a 5-year period. This agreement will expand Covance s footprint in the genomics testing market.

Table of Contents

Covance expects to complete this transaction and assume responsibility for the operations in the third quarter of 2009, at which time the cash consideration will be paid.

Investing activities for the six months ended June 30, 2008 also included $3.9 million of additional proceeds received during the period from contingent consideration related to transferred backlog from the sale of Covance s cardiac safety service offering in November 2007.

Financing activities for the six months ended June 30, 2009 and 2008 provided $5.4 million and used $80.7 million, respectively. During the six months ended June 30, 2009, Covance borrowed an additional $8.0 million under the Credit Facility. Additionally, $1.5 million in proceeds were received from the exercise of stock options and $3.7 million was received from employee contributions to the Company s employee stock purchase plan, partially offset by $2.3 million used to purchase into treasury 58,417 shares of common stock in connection with employee benefit plans. Also, in March 2009, Covance repaid the entire $5.4 million balance of mortgage debt assumed in connection with the Swiss Pharma acquisition. During the six months ended June 30, 2008, $126.7 million was used to purchase into treasury 1,500,000 shares of common stock under the share buyback program authorized by Covance s Board of Directors and $3.7 million was used to purchase into treasury 44,796 shares of common stock in connection with employee benefit plans; partially offset by $8.4 million in proceeds from the exercise of stock options, $3.4 million from employee contributions to the Company s employee stock purchase plan and $2.9 million in excess tax benefits realized on the exercise of stock options.

Inflation

While most of Covance s net revenues are earned under contracts, the long-term contracts (those in excess of one year) generally include an inflation or cost of living adjustment for the portion of the services to be performed beyond one year from the contract date. As a result, Covance believes that the effects of inflation generally do not have a material adverse effect on its operations or financial condition.

Recently Issued Accounting Standards

In December 2008, the FASB issued FASB Staff Position 132(R)-1 (FSP 132(R)-1), which provides guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. FSP 132(R)-1 requires disclosure of investment allocation methodologies and information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets in order to provide users with an understanding of significant concentrations of risk in plan assets. FSP 132(R)-1 is effective for years ending after December 15, 2009. FSP 132(R)-1 requires additional disclosure only and therefore will not impact Covance s consolidated results of operations or financial position.

In April 2009, the FASB issued FASB Staff Position 107-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1) to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* and APB Opinion No. 28, *Interim Financial Reporting* (APB 28). FSP 107-1 is effective for interim reporting periods ending after June 15, 2009 and was adopted by Covance during the quarter ended June 30, 2009. FSP 107-1 requires additional disclosure only and therefore did not impact Covance s results of operations or financial position. See Notes 4 and 6 to the unaudited consolidated financial statements included elsewhere in this quarterly report for information related to the fair value of Covance s financial instruments.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes general standards of disclosure about events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009 and was adopted by Covance during the quarter ended June 30, 2009. SFAS 165 requires additional disclosure only and therefore did not impact Covance s results of operations or financial position. See Note 10 to unaudited consolidated financial statements included elsewhere in this quarterly report.

Table of Contents

Forward-Looking Statements. *Statements in this Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as in certain other parts of this Quarterly Report on Form 10-Q that look forward in time, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, expectations, predictions, and assumptions and other statements which are other than statements of historical facts. All such forward-looking statements are based on the current expectations of management and are subject to, and are qualified by, risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, without limitation, competitive factors, outsourcing trends in the pharmaceutical industry, levels of industry research and development spending, the Company s ability to continue to attract and retain qualified personnel, the fixed price nature of contracts or the loss of large contracts, risks associated with acquisitions and investments, the closings of the acquisition of Merck s genomics laboratory and the divestiture of the company s IVR service offering, the Company s ability to increase order volume, the pace of translation of orders into revenue in late-stage development services, fluctuations in currency exchange rates, and other factors described in Covance s filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K.*

Item 3. Quantitative and Qualitative Disclosure About Market Risk

For the six months ended June 30, 2009, approximately 40% of our net revenues were derived from our operations outside the United States. We do not engage in material or long-term derivative or hedging activities related to our potential foreign exchange exposures. See Management s Discussion and Analysis of Financial Condition and Results of Operations Foreign Currency Risks for a more detailed discussion of our foreign currency risks and exposures.

Covance s short-term investments are with major financial institutions in countries whose governments guarantee those investments (primarily in Ireland and the United Kingdom). These short-term investments are in bank deposits and money market funds which can be readily purchased and sold using established markets. Covance s cash investment policy is to maximize utilization of excess cash according to the following specific criteria (in order of priority): (1) preserve capital (minimize financial market risk); (2) maintain liquidity; (3) manage foreign exchange rate exposure (internal hedging); (4) maximize rate of return; and (5) enhance strategic relationships with select financial institutions. Covance also has strong operating cash flow and ready access to credit available under its Credit Facility.

Item 4. Controls and Procedures

Disclosure controls and procedures. The Company s Principal Executive Officer and Principal Financial Officer have reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures as of the end of the period covered in this report. Based on that evaluation, the Principal Executive Officer and the Principal Financial Officer have concluded that the Company s current disclosure controls and procedures are effective. In connection with Covance s focus on investing in infrastructure to enhance our ability to manage expected future growth, the Company is in the process of implementing a number of PeopleSoft® financial software modules (PeopleSoft Financials). Implementation began in the fourth quarter of 2008 and is expected to be substantially complete in late 2009. As the Company continues to implement PeopleSoft Financials, it expects that there will be future changes and further improvements in internal controls as a result of this implementation. During the quarter ended June 30, 2009,

our central laboratory services in our late-stage development segment implemented PeopleSoft Financials, which resulted in certain changes and enhancements to the Company s internal controls. PeopleSoft Financials, along with the internal controls over financial reporting impacted by the implementation, were tested for design effectiveness. While some processes and controls will continue to evolve as the implementation progresses, existing controls and the controls affected by the implementation of PeopleSoft Financials were evaluated as appropriate and effective. There were no other changes in the Company s internal control over financial reporting during the second quarter of 2009 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

Part II. Other Information

Item 1A. Risk Factors

This section discusses various risk factors that are attendant with our business and the provision of our services. If the events outlined below were to occur individually or in the aggregate, our business, results of operations, financial condition, and cash flows could be materially adversely affected.

Changes in government regulation or in practices relating to the pharmaceutical industry could decrease the need for the services we provide.

Governmental agencies throughout the world, including in the United States, strictly regulate the drug development process. Our business involves helping pharmaceutical and biotechnology companies navigate the regulatory drug approval process. Changes in regulation, such as a relaxation in regulatory requirements or the introduction of simplified drug approval procedures, or an increase in regulatory requirements that we have difficulty satisfying or that make our services less competitive, could eliminate or substantially reduce the demand for our services. Also, if government efforts to contain drug costs and pharmaceutical and biotechnology company profits from new drugs, our customers may spend less, or reduce their growth in spending on research and development. If health insurers were to change their practices with respect to reimbursements for pharmaceutical products, our customers may spend less, or reduce their growth in spending on research and development.

Failure to comply with existing regulations could result in a loss of revenue or earnings or in increased costs.

Any failure on our part to comply with applicable regulations could result in the termination of on-going research or the disqualification of data for submission to regulatory authorities. For example, if we were to fail to properly monitor compliance by clinical trial investigators with study protocols, 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 customer, but at substantial cost to us.

We may bear financial losses because most of our contracts are of a fixed price nature and may be delayed or terminated or reduced in scope for reasons beyond our control.

Many of our contracts provide for services on a fixed price or fee-for-service with a cap basis and they may be terminated or reduced in scope either immediately or upon notice. Cancellations may occur for a variety of reasons, including:

- the failure of products to satisfy safety requirements;

- unexpected or undesired results of the products;
- insufficient patient enrollment;
- insufficient investigator recruitment;
- the client s decision to terminate the development of a product or to end a particular study; and
- our failure to perform properly our duties under the contract.

The loss, reduction in scope or delay of a large contract or the loss or delay of multiple contracts could materially adversely affect our business, although our contracts frequently entitle us to receive the costs of winding down the terminated projects, as well as all fees earned by us up to the time of termination. Some contracts also entitle us to a termination fee.

We may bear financial risk if we under price our contracts or overrun cost estimates.

Since our contracts are often structured as fixed price or fee-for-service with a cap, we bear the financial risk if we initially under price our contracts or otherwise overrun our cost estimates. Such under pricing or significant cost overruns could have a material adverse effect on our business, results of operations, financial condition, and cash flows.

We may not be able to successfully develop and market or acquire new services.

We may seek to develop and market new services that complement or expand our existing business or expand our service offerings through acquisition. If we are unable to develop new services and/or create demand for those newly developed services, or to expand our service offerings through acquisition, our future business, results of operations, financial condition, and cash flows could be adversely affected.

Table of Contents

Our quarterly operating results may vary.

Our operating results may vary significantly from quarter to quarter and are influenced by factors over which we have little control such as:

- changes in the general global economy;
- exchange rate fluctuations;
- the commencement, completion and delay or cancellation of large projects or groups of projects;
- the progress of ongoing contracts;
- the timing of and charges associated with completed acquisitions or other events; and
- changes in the mix of our services.

We believe that operating results for any particular quarter are not necessarily a meaningful indication of future results. While fluctuations in our quarterly operating results could negatively or positively affect the market price of our common stock, these fluctuations may not be related to our future overall operating performance.

We depend on the pharmaceutical and biotechnology industries.

Our revenues depend greatly on the expenditures made by the pharmaceutical and biotechnology industries in research and development. In some instances, companies in these industries are reliant on their ability to raise capital in order to fund their research and development projects. Accordingly, economic factors and industry trends that affect our clients in these industries also affect our business. If companies in these industries were to reduce the number of research and development projects they conduct or outsource, our business could be materially adversely affected.

We operate in a highly competitive industry.

Competitors in the contract research organization industry range from small, limited-service providers to full service global contract research organizations. Our main competition consists of in-house departments of pharmaceutical companies, full-service and functional contract research organizations**,** and, to a lesser degree, universities and teaching hospitals. We compete on a variety of factors, including:

- reputation for on-time quality performance and regulatory compliance;
- expertise and experience in specific areas;
- scope of service offerings;
- strengths in various geographic markets;
- price;
- technological expertise and efficient drug development processes;
- quality of facilities;
- ability to acquire, process, analyze and report data in an accurate manner;
- ability to manage large-scale clinical trials both domestically and internationally;
- expertise and experience in market access services; and
- size.

For instance, our clinical development services have from time to time experienced periods of increased price competition which had a material adverse effect on Covance s late-stage development profitability and consolidated net revenues and net income.

There is competition among the larger contract research organizations for both clients and potential acquisition candidates. Additionally, small, limited-service entities considering entering the contract research organization industry will find few barriers to entry, thus further increasing possible competition. These competitive pressures may affect the attractiveness of our services and could adversely affect our financial results.

Table of Contents

Unfavorable general economic conditions could negatively impact our operating results and financial condition.

Unfavorable global economic conditions, including the current recession in the United States and the recent financial crisis affecting the banking system and financial markets, could negatively affect our business. While it is difficult for us to predict the impact of general economic conditions on our business, these conditions could reduce customer demand for some of our services, which could cause our revenue to decline. Also, our customers, particularly smaller biotechnology companies which are especially reliant on the credit and capital markets, may not be able to obtain adequate access to credit or equity funding, which could affect their ability to make timely payments to us. If that were to occur, we could be required to increase our allowance for doubtful accounts, and the number of days outstanding for our accounts receivable could increase. For these reasons, among others, if the current economic conditions persist or decline, our operating results and financial condition could be adversely affected.

Weaknesses in the credit markets could negatively impact the Company s access to capital.

The Company s early development services have in the past required continuing infrastructure expansions and acquisition of capital assets. The Company has been able to fund its capital needs largely from cash on hand and cash from operations as well as from its revolving credit facility. While the Company recently entered into a new $150.0 million revolving credit facility expiring in June 2012 to replace its previous credit facility which was due to expire on June 30, 2009, and the credit facility may be expanded to $200.0 million at the Company s election, should the Company need access to additional funding, the turmoil in the credit markets that began in 2008 could affect the Company s ability to do so and such funding could be at an increased cost.

We may expand our business through acquisitions.

We review many acquisition candidates and, in addition to acquisitions which we have already made, we are continually evaluating new acquisition opportunities. Factors which may affect our ability to grow successfully through acquisitions include:

- difficulties and expenses in connection with integrating the acquired companies and achieving the expected benefits;
- diversion of management s attention from current operations;
- the possibility that we may be adversely affected by risk factors facing the acquired companies;
- acquisitions could be dilutive to earnings, or in the event of acquisitions made through the issuance of our common stock to the shareholders of the acquired company, dilutive to the percentage of ownership of our existing stockholders;
- potential losses resulting from undiscovered liabilities of acquired companies not covered by the indemnification we may obtain from the seller;
- risks of not being able to overcome differences in foreign business practices, language and other cultural barriers in connection with the acquisition of foreign companies; and

- loss of key employees of the acquired companies.

We may be affected by potential health care reform.

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

Implementation of health care reform legislation that contain costs could limit the profits that can be made from the development of new drugs. This could adversely affect research and development expenditures by pharmaceutical and biotechnology companies which could in turn decrease the business opportunities available to us both in the United States and abroad. In addition, new laws or regulations may create a risk of liability, increase our costs or limit our service offerings.

We rely on third parties for important services.

We depend on third parties to provide us with services critical to our business. The failure of any of these third parties to adequately provide the needed services could have a material adverse effect on our business.

Table of Contents

Our revenues and earnings are exposed to exchange rate fluctuations.

We derive a large portion of our net revenues from international operations. For the six months ended June 30, 2009, we derived approximately 40% of our net revenues from outside the United States. Since our financial statements are denominated in U.S. dollars, fluctuations in exchange rates from period to period will have an impact on our reported results. For example, in the first half of 2009, the U.S. Dollar was considerably stronger against the currencies of our most significant foreign operations (The British Pound, the Swiss Franc and the Euro) than in the first half of the prior year. This strengthening of the U.S. Dollar negatively impacted Covance s first half 2009 year over year revenue growth by approximately $56 million or 660 basis points. In addition, in certain circumstances, we may incur costs in one currency related to our services or products for which we are paid in a different currency. As a result, factors associated with international operations, including changes in foreign currency exchange rates, could significantly affect our results of operations, financial condition and cash flows.

The loss of our key personnel could adversely affect our business.

Our success depends to a significant extent upon the efforts of our senior management team and other key personnel. The loss of the services of such personnel could adversely affect our business. Also, because of the nature of our business, our success is dependent upon our ability to attract and retain technologically qualified personnel. There is substantial competition for qualified personnel, and an inability to recruit or retain qualified personnel may impact our ability to grow our business and compete effectively in our industry.

Contract research services create a risk of liability.

In contracting to work on drug development trials and studies, we face a range of potential liabilities, for example:

- errors or omissions that create harm during a trial to study volunteers or after a trial to consumers of the drug after regulatory approval of the drug;
- general risks associated with clinical pharmacology facilities, including negative consequences from the administration of drugs to clinical trial participants or the professional malpractice of clinical pharmacology medical care providers;
- errors or omissions from tests conducted for the agrochemical and food industries;
- risks that animals in our breeding facilities may be infected with diseases that may be harmful and even lethal to themselves and humans despite preventive measures contained in our company policies for the quarantine and handling of imported animals; and
- errors and omissions during a trial that may undermine the usefulness of a trial or data from the trial or study.

We also contract with physicians, also referred to as investigators, to conduct the clinical trials to test new drugs on human volunteers. These tests can create a risk of liability for personal injury or death to volunteers, resulting from negative reactions to the drugs administered or from

professional malpractice by third party investigators. We believe that our risks in this area are generally reduced by the following:

- contract provisions entitling us to be indemnified or entitling us to a limitation of liability;
- insurance maintained by our clients, investigators, and by us; and
- our efforts to comply with various regulatory requirements we must follow in connection with our business.

Contractual indemnifications generally do not protect us against liability arising from certain of our own actions, such as negligence or misconduct. We could be materially and adversely affected if we were required to pay damages or bear the costs of defending any claim which is not covered by a contractual indemnification provision or in the event that a party who must indemnify us does not fulfill its indemnification obligations or which is beyond the level of our insurance coverage. There can be no assurance that we will be able to maintain such insurance coverage on terms acceptable to us.

Hardware and software failures, delays in the operation of our computer and communications systems or the failure to implement system enhancements may harm our business.

Our success depends on the efficient and uninterrupted operation of our computer and communications systems. A failure of our network or data gathering procedures could impede the processing of data, delivery of databases and services, client orders and day-to-day management of our business and could result in the corruption or loss of data. While certain of our operations have appropriate disaster recovery plans in place, we currently do not have redundant facilities everywhere in the

Table of Contents

world to provide IT capacity in the event of a system failure. Despite any precautions we may take, damage from fire, floods, hurricanes, power loss, telecommunications failures, computer viruses, break-ins and similar events at our various computer facilities could result in interruptions in the flow of data to our servers and from our servers to our clients. In addition, any failure by our computer environment to provide our required data communications capacity could result in interruptions in our service. In the event of a delay in the delivery of data, we could be required to transfer our data collection operations to an alternative provider of server hosting services. Such a transfer could result in delays in our ability to deliver our products and services to our clients. Additionally, significant delays in the planned delivery of system enhancements, improvements and inadequate performance of the systems once they are completed could damage our reputation and harm our business. Finally, long-term disruptions in the infrastructure caused by events such as natural disasters, the outbreak of war, the escalation of hostilities, and acts of terrorism (particularly involving cities in which we have offices) could adversely affect our businesses. Although we carry property and business interruption insurance, our coverage may not be adequate to compensate us for all losses that may occur.

Reliance on facilities.

Covance relies on certain of its facilities. In particular, Covance s preclinical and central laboratory facilities are highly specific and would be difficult to replace in a short period of time. Any event that causes a disruption of the operation of these facilities might impact the Company s ability to provide service to its customers and therefore could have a material adverse affect on its financial condition, results of operations and cash flows.

Reliance on air transportation.

Our central laboratories and certain of our other businesses are heavily reliant on air travel for transport of clinical trial kits and other material, products and people, and a significant disruption to the air travel system, or our access to it, could have a material adverse effect on our business.

Certain service offerings and research products are dependent on limited sources of supply of services or products which if interrupted could affect our business.

We depend on a limited number of suppliers for certain services and for certain animal populations. Disruptions to the continued supply of these services or products may arise from export import restrictions or embargoes, foreign political or economic instability, or otherwise. Disruption of supply could have a material adverse effect on our business.

Actions of animal rights extremists may affect our business.

Our early development services utilize animals in preclinical testing of the safety and efficacy of drugs and also breed and sell animals for biomedical research. Such activities are required for the development of new medicines and medical devices under regulatory regimes in the United States, Europe, Japan and other countries. Acts of vandalism and other acts by animal rights extremists who object to the use of animals in drug development could have a material adverse effect on our business.

Our animal populations may suffer diseases that can damage our inventory, harm our reputation, result in decreased sales of research products or result in other liability to us.

It is important that our research products be free of diseases, including infectious diseases. The presence of diseases can distort or compromise the quality of research results, can cause loss of animals in our inventory, can result in harm to humans or outside animal populations if the disease is not contained to animals in inventory, or can result in other losses. Such results could harm our reputation or have a material adverse effect on our financial condition, results of operations, and cash flows.

Table of Contents

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders of Covance was held on May 7, 2009, pursuant to notice.

Three directors were reelected to the Board of Directors with the following votes cast: Robert Barchi received 55,652,664 votes for and 1,928,575 votes were withheld; Sandra Helton received 56,764,177 votes for and 817,062 votes were withheld; Joseph Scodari received 56,762,730 votes for and 818,509 votes were withheld. At the meeting, John McCartney was newly appointed to the Board of Directors. The following directors terms of office as a director continued after the meeting: Kathleen Bang, Gary Costley, Joe Herring and Bradley Sheares.

The shareholders ratified the appointment of Ernst & Young LLP as the Company s independent auditors with the following votes cast: 55,082,907 votes for, 2,464,205 votes against and 34,127 votes abstained.

A shareholder proposal relating to Board reports of United States Department of Agriculture citations was rejected, with 37,030,418 votes against, 3,928,811 votes for, 8,865,339 votes abstained, and 7,756,671 broker non-votes.

Item 6. Exhibits

31.1	Certification Joseph L. Herring. ***Filed herewith.***
31.2	Certification William E. Klitgaard. ***Filed herewith.***
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Joseph L. Herring. ***Filed herewith.***
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 William E. Klitgaard. ***Filed herewith.***
101	The following financial information from the Covance s Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, filed on August 4, 2009, formatted in XBRL (Extensible Business Reporting Language) includes (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements, tagged as blocks of text. ***Furnished electronically herewith.***

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.

COVANCE INC.

Dated: August 4, 2009	By:	/s/ Joseph L. Herring Joseph L. Herring Chairman of the Board and Chief Executive Officer

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

Signature	Title	Date
/s/ Joseph L. Herring Joseph L. Herring	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	August 4, 2009
/s/ William E. Klitgaard William E. Klitgaard	Corporate Senior Vice President and Chief Financial Officer (Principal Financial Officer)	August 4, 2009
/s/ Michele A. Kennedy Michele A. Kennedy	Corporate Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer)	August 4, 2009

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification Joseph L. Herring. ***Filed herewith.***
31.2	Certification William E. Klitgaard. ***Filed herewith.***
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Joseph L. Herring. ***Filed herewith.***
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 William E. Klitgaard. ***Filed herewith.***
101	The following financial information from the Covance s Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, filed on August 4, 2009, formatted in XBRL (Extensible Business Reporting Language) includes (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements, tagged as blocks of text. ***Furnished electronically herewith.***