

BIO IMAGING TECHNOLOGIES INC
Form 10KSB
March 29, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

Commission File No. 1-11182

BIO-IMAGING TECHNOLOGIES, INC.

(Name of Small Business Issuer in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)
826 Newtown-Yardley Road,
Newtown, Pennsylvania

11-2872047
(I.R.S. Employer
Identification No.)
18940-1721

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(Address of Principal Executive Offices)

(Zip Code)

(267) 757-3000

(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class

Name of each exchange on which registered

None

None

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

Common Stock, \$.00025 par value per share

NASDAQ National Market

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for fiscal year ended December 31, 2003: \$24,971,184

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant: \$52,549,765 at February 29, 2004 based on the average bid and asked prices on that date.

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of February 27, 2004:

Class

Number of Shares

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Common Stock, \$.00025 par value

10,754,864

Transitional Small Business Disclosure Format Yes: No:

The following documents are incorporated by reference into the Annual Report on Form 10-KSB: Portions of the Registrant's definitive Proxy Statement for its 2004 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report.

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PART I

Item 1. Business.

Overview

Bio-Imaging is a global pharmaceutical contract service organization, providing services that support the product development process of the pharmaceutical, biotechnology and medical device industries. We specialize in assisting our clients in the design and management of the medical imaging component of clinical trials for all modalities, which consist of computerized tomography, magnetic resonance imaging, x-rays, dual energy x-ray absorptiometry, or DEXA, position emission tomography, single photon emission computerized tomography and ultrasound.

We utilize proprietary processes and software applications in providing our services to pharmaceutical companies conducting clinical studies in which medical imaging modalities are used to evaluate the efficacy and safety of pharmaceuticals, biologics or medical devices. Our digital image processing and computer analysis techniques enable technologists or radiologists to make highly precise measurements and biostatistical inferences about drug or device effects. The resulting data enables our clients and regulatory reviewers, primarily the U.S. Food and Drug Administration and comparable European agencies, to evaluate product efficacy and safety. In addition, we have developed specialized computer services and software applications that enable independent radiologists and other medical specialists involved in clinical trials to review medical image data in an entirely digital format. Our services also include the following:

Regulatory submission of medical images, quantitative data and text;

DEXA quality assurance and quality control to the pharmaceutical and medical device industry for studies requiring bone densitometry and body composition measurements; and

Bio-Imaging ET&CSM services, which focus on education, training and certification for medical imaging equipment, facilities and staff.

We are directing our marketing and sales efforts towards those clinical development areas that heavily depend upon medical imaging. These areas include oncology, musculoskeletal, central nervous system and cardiovascular.

We have a European facility in Leiden, the Netherlands that provides centralized image processing services for our European clients. We manage our services for European-based clinical trials from this facility. Our European facility has the same processing and analysis capabilities as our United States headquarters.

In November 2003, we acquired the intellectual property of CapMed Corporation, located in Wilmington, Delaware, referred to as CapMed, including the Personal Health Record software, referred to as PHR, and the patent-pending Personal HealthKey technology. The PHR is a software application that enables users to manage and store personal health information, including their medical images, on the privacy of their desktop computer, while linking directly to sponsor-directed resources such as drug information, patient education, or disease guidelines. The Personal HealthKey plugs into a computer's USB port, allowing doctors and patients easy access to the patient's medical record without the need

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for additional hardware or software, and it is password protected.

We were incorporated in Delaware in 1987 under the name Wise Ventures, Inc. Our name was changed to Bio-Imaging Technologies, Inc. in 1991. The address of our principal executive offices is 826 Newtown-Yardley Road, Newtown, Pennsylvania, 18940, and our telephone number is 267-757-3000. Our Internet website is www.bioimaging.com. We also utilize the Internet website www.capmed.com for the CapMed division of our business. We make available on our Internet website all of our public filings with the Securities and Exchange Commission. However, nothing on our Internet website is intended to be incorporated by reference into this Form 10-KSB or any other filing made by us with the Securities and Exchange Commission.

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Business Services

Core Laboratory Services

We are a leading provider of medical imaging management services for clinical development purposes. Our imaging core laboratory facilities in the United States and Europe provide centralized image data collection, processing, analysis and archival services for clinical trials conducted worldwide. The facilities are designed for high-volume efficient processing of film and digital image data in a secure environment that complies with regulatory guidelines for clinical data management.

Medical image data are received by us from clinical trial sites, located throughout the world. We have developed procedures for data tracking and quality control that we believe to be of significant value to our clients. Our facilities contain specialized hardware and software for the digitization of films and translation of digital data, enabling data to be standardized, regardless of its source. We believe our ability to handle most commercially available image file formats is a valuable technical asset and an important competitive advantage in gaining new business for large global multi-center clinical trials.

We perform image analyses on client data using internally developed or specially configured software. We measure key indicators of drug efficacy in different organs and disease states. The results from image analysis derived in our facilities are transferred to databases that can be transmitted electronically to our clients or integrated directly into our Bio/ImageBase package for regulatory submission on our clients' behalf.

Information Management Services

Our information management services focus on providing specialized solutions for improving the quality, speed and flexibility of image data management for clinical trials. We believe that our Computer Assisted Masked Reading systems, or CAMR systems, offer numerous advantages over conventional film-based medical image reading scenarios, including increased reading speed, greater standardization of image reading, and reduced error in the capture of reader interpretations.

Using our CAMR systems, independent medical specialists can review medical image data from clinical trials in a digital format. The CAMR systems can display all modalities of medical image data, regardless of source equipment. In addition, the systems can display either translated digital data or digitized films. Such image reviews are often required during clinical trials to evaluate patients' responses to therapy or to determine if patients qualify for studies. By using the CAMR systems to read and evaluate image data, medical specialists can achieve greater reading speed than is possible with film and can perform evaluations in a more objective, reproducible manner.

We have also developed remote CAMR systems, or rCAMR systems, that are located on the premises, either home or office, of the individual medical specialists who are engaged by the sponsor to perform the analysis of the medical image data. Historically, the CAMR systems have been utilized to determine efficacy of the compounds being studied. More recently, clients are requesting us to provide rapid turn-around reads for inclusion/exclusion criteria. We believe that the rCAMR system is the optimal tool for this type of work because it allows us, at our clients' discretion, to provide the images to an expert in the field to facilitate the review of the images from the expert's office or home.

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We have developed an image database software application, Bio/ImageBase, that enables our clients to submit their medical images and related clinical data to the FDA in a digital format. Using data stored on CD-ROM or DVD disks, Bio/ImageBase allows clients and FDA medical reviewers to review medical images and related clinical data. We believe that Bio/ImageBase offers the potential to decrease review time, resulting in faster regulatory approvals and reduced time-to-market for new drugs, biologics and medical devices.

Our Bio/ImageBase software has been installed at client sites and on two off-the-shelf image reading and review computer systems at the FDA. We have been using our Bio/ImageBase software to submit medical

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images and related data to the FDA since mid-1993. In March 1996, Bio/ImageBase was cited in the FDA's 1996 Computer-Assisted Product License Application Guidance Manual as an acceptable database for submission of imaging data.

Education, Training and Certification

Bio-Imaging ET&CSM focuses on education, training and certification for medical imaging equipment, facilities and staff. A program of Instrument Quality Control will provide physicians with a method of ensuring that systems operate to specifications on a continual basis. This program is designed to protect the accuracy of diagnostic interpretation of bone density data and give the physicians current and in-depth feedback on the status of their instruments. In addition, Bio-Imaging ET&CSM will train entry-level physicians and allied health professionals in routine clinical practice.

CapMed Division

Our CapMed division includes the PHR, which is a software application that enables users to manage and store personal health information, including their medical images, on the privacy of their desktop computer, while linking directly to sponsor-directed resources such as drug information, patient education or disease guidelines. CapMed also includes the Personal HealthKey that plugs into a computer's USB port, allowing doctors and patients easy access to the patient's medical record without the need for additional hardware or software, and it is password protected.

Other Services

We provide technical consulting in the evaluation of the sites that may participate in clinical trials. We also consult with clients regarding regulatory issues involved in the design, execution, analysis and submission of medical image data in clinical trials.

Target Markets

Our primary target market is comprised of pharmaceutical, biotechnology and medical device companies whose clinical development pipelines include drugs, biologics or devices that are typically evaluated by medical imaging methods. This target market includes leading international pharmaceutical companies and biotechnology companies with products currently in the clinical development pipeline.

We focus our marketing on the following stages of clinical development:

Phase II - Clinical Trials

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Phase II clinical trials are generally conducted over six months to two years and involve basic efficacy, safety and dose-range testing in approximately 50 to 400 patients suffering from the disease or condition under study. Such trials help determine the best effective dose, confirm that the drug works as expected and provide initial safety data.

Phase III - Clinical Trials

Phase III clinical trials are generally conducted over one to four years and involve efficacy and safety studies in broader populations of hundreds or thousands of patients and many investigational sites, such as hospitals and clinics. These trials are sometimes referred to as pivotal studies for submission to the regulatory agencies. Generally, Phase III studies are intended to provide additional information on drug safety and efficacy, and the evaluation of the risk-benefit of the drug and information for the adequate labeling of the product.

Phase IV - Post Approval Studies

Phase IV studies are studies conducted after a pharmaceutical drug or device has been approved for use. These studies are generally conducted over a two to four year period and involve either a continuation of a

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Phase III patient population or the recruitment of a new patient population. As there continues to be pressure to expedite approval of pharmaceuticals and medical devices, there is an increase in the number of conditional approvals based on the conduct of additional Phase IV studies.

We further focus our marketing efforts on Phase II, III and IV clinical trials for the following classes of drugs:

Musculoskeletal Therapeutics

Anti-inflammatory clinical trials, such as those focused on arthritis, include radiologic evaluation of the bones and joints to determine drug efficacy. We believe that demand among drug developers for our services will increase as new classes of biotechnology-derived drugs enter and progress through the clinical development pipeline.

Osteoporosis is a disease characterized by thinning bones, which leads to fractures in the elderly. The FDA guidance document for developing treatments for this disease recognized DEXA as one of the primary efficacy and safety measurement tools available. Furthermore, all data needs to go through a quality assurance laboratory. This is now standard practice in all studies using DEXA instruments whether for osteoporosis oncology or anti-obesity or muscle wasting assessment.

Cancer Therapeutics

Many pharmaceutical companies are currently developing new therapies for the treatment of cancer. For solid tumor studies, medical imaging modalities are used to determine the response of treated and untreated tumors. These medical images are evaluated by medical specialists during the course of oncology clinical trials to determine the extent of disease and changes in tumor size over time.

The FDA's guidelines aimed at accelerating access to new drugs for the review and approval of new cancer therapies place greater emphasis on shrinkage of tumors as an early indicator of anti-tumor efficacy. We believe that these FDA guidelines may have a favorable impact on our business as pharmaceutical and biotechnology companies may have an increased need for regulatory compliant medical imaging services to conduct their oncology clinical trials.

Central Nervous System Therapeutics

Various pharmaceutical companies are currently developing drugs for treatment of diseases and conditions of the central nervous system, most of which are evaluated with the aid of medical imaging. Most later-stage clinical trials for these serious and costly conditions involve the evaluation of medical image data. We believe that the central nervous system clinical trials business may increase as more therapies progress through the research pipeline.

Diagnostic Imaging Agents

We provide our services to clients developing diagnostic imaging agents that are designed to diagnose disease conditions more quickly and accurately in their development in order to facilitate earlier and more accurate treatment.

Cardiovascular Therapeutics

Various pharmaceutical companies are currently developing drugs for the diagnosis and treatment of cardiovascular diseases and conditions that are evaluated with the aid of medical imaging. We provide our services to clients developing diagnostic agents for the detection and treatment of these conditions.

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Market Trends

We believe that demand for our services should grow because of a variety of favorable regulatory, technological and market trends:

The FDA initiatives to streamline the regulatory submission and review process that are being implemented should have a beneficial impact on us. The FDA is investing in new information technology and is continuing the process of formulating and disseminating guidelines for standardizing the submission of electronic data, including medical images. We expect submission of image data to be a requirement in key therapeutic and diagnostic areas for evaluating the effectiveness of a drug or imaging agent.

Consolidation, restructuring and downsizing in the pharmaceutical industry in response to downward pressure on certain pharmaceutical and biotechnology companies' drug prices has resulted in increased outsourcing of certain research and development activities.

Overall, growth in pharmaceutical and biotechnology research and development spending is increasing. As a result, we believe that the outsourcing of development activities should like-wise increase.

New classes of drugs to treat conditions traditionally evaluated by imaging are entering or progressing through the clinical development pipeline, leading to increased demand for medical imaging-related services. In addition, we believe that digital technologies for data acquisition and management are penetrating the radiology community.

We believe that as pharmaceutical and biotechnology companies increasingly attempt to expand the market for new drugs by conducting clinical trials and pursuing regulatory approval in multiple countries simultaneously, contract service organizations with a global presence and expertise will continue to benefit.

Intellectual Property

Proprietary protection for our computer-imaging programs, processes and know-how is important to our business. We have developed certain technically derived procedures and computer software applications that are intended to increase the effectiveness and quality of our services. We rely upon patents, trademarks, copyrights, trade secrets, know-how and continuing technological innovation to develop and maintain our competitive position. We have claimed trademark protection for Bio/ImageBase, CAMR, rCAMR, Intelligent Imaging and Personal Health Key. We hold patents for the two DEXA phantoms, titled Spine and Variable Composition Phantoms, which we sell to trial sites. We have a patent pending on our Personal Health Key. We have registered our Stylized Man Design with the U.S. Patent and Trademark Office. We cannot assure you that we can limit unauthorized or wrongful disclosures of trade secrets or otherwise confidential information. In addition, to the extent we rely on trade secrets and know-how to maintain our competitive technological position, we cannot assure you that others may not develop independently the same, similar or superior techniques. Although our intellectual property rights are important to the results of our operations, we believe that other factors, such as our independence, process knowledge, technical expertise and experience are more important, and that, overall, these technological capabilities offer significant benefits to our clients.

Government Regulation

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The research and development, manufacture and marketing of drugs and medical devices are subject to stringent regulation by the FDA in the United States and by similar authorities in other countries. In addition, regulations imposed by other federal agencies, as well as state and local authorities, may impact such research and development, manufacturing and marketing.

The FDA has established mandatory procedures and safety standards that apply to the clinical testing, manufacturing and marketing of drugs and medical devices. These procedures and safety standards include, among other things, the completion of adequate and well-controlled human clinical trials to establish the safety

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and efficacy of the drug or device for its recommended conditions or use. We advise our clients in the execution of clinical trials and other drug and device developmental tasks. We do not administer drugs to or utilize medical devices on patients.

The success of our business is dependent upon continued acceptance by the FDA and other regulatory authorities of the data and analyses generated by our services in connection with the evaluation of the safety and efficacy of new drugs and devices. The FDA has formal guidelines that encourage the use of surrogate measures, through submission of digital image data, for evaluation of drugs to treat life-threatening or debilitating conditions. We cannot assure you that the FDA or other regulatory authorities will accept the data or analyses generated by us in the future and, even assuming acceptance, we cannot assure you that the FDA or other regulatory authorities will require the application of imaging techniques to numbers of patients and over time periods substantially similar to those required of traditional safety and efficacy techniques.

Changes in the FDA's policy for the evaluation of therapeutic oncology agents may have a positive impact on the time to market of such therapeutics. According to the guidelines announced in March 1996, approval times for new cancer therapies can be shortened if evidence of tumor shrinkage is verifiable and demonstrable through the use of objective measurement techniques. These guidelines place much greater reliance on the use of medical image data to demonstrate objective tumor shrinkage. In addition, in March 1997, the FDA announced new guidelines aimed at accelerating all therapeutic categories through the use of imaging markers such as surrogate endpoints for measuring therapeutic effectiveness. We believe the FDA's initiatives to streamline and accelerate the submission and review process of therapeutic agents may have a favorable impact on our business.

In May 2003, the FDA released draft guidance for the industry relating to how medical imaging should be defined, handled and evaluated in clinical trials. We believe that this guidance comports with the methodologies and processes utilized by us in providing medical information management services for our clients.

We believe that our ability to achieve continued and sustainable growth will be materially dependent upon, among other factors, the continued stringent enforcement of the comprehensive regulatory framework by various government agencies. Any significant change in these regulatory requirements or the enforcement thereof, especially relaxation of standards, could adversely affect our prospects.

The current European market regulation is more fragmented than in the United States. However, we believe that our expertise in working with the standards of the FDA provides us with experience when working with the various European regulatory agencies.

Competition

We continue to experience competition from commercial competitors and academic research centers. The biopharmaceutical services industry is highly competitive, and we face numerous potential competitors in our business, including hundreds of contract research organizations. We primarily compete against small specialty contract research organizations, or CROs, and to a lesser extent, universities and teaching hospitals. As competition increases, we will look to provide value-added services and undertake marketing and sales programs to differentiate our services based on our expertise and experience in specific therapeutic and diagnostic areas, our technical expertise, our regulatory and clinical development experience, our quality performance and our international capabilities. Our competitive position also depends upon our ability to attract and retain qualified personnel and develop and preserve proprietary technology, processes and know-how. Competition in our industry has resulted in additional pressure being placed on price, service and quality. Although we believe that we are well positioned against our competitors due to our experience in clinical trials and regulatory compliance along with our international presence, we cannot assure you that our competitors or clients will not provide or develop services similar or superior to those provided by us. This competition could have a material adverse impact on us.

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Marketing and Sales

We provide and market our services on an international basis primarily to pharmaceutical and biotechnology companies. Our sales and marketing activities are directed by a Senior Vice President of Business Development and supported by in-house staff and field business development personnel.

Our selling efforts are focused on North America and Western Europe. Sales efforts are directed from both of our headquarters in Pennsylvania and Leiden, the Netherlands. Our marketing activities include exhibiting at major trade shows, advertising in trade journals and the sponsoring of industry associations.

Significant Clients

During fiscal 2003, one client, NPS Pharmaceuticals, Inc., or NPS, accounted for approximately 14% of our project revenues encompassing four projects. However, no one contract with NPS accounted for more than 10% of project revenues. No other customer accounted for more than 10% of project revenues. These contracts are terminable by our client at any time and for any reason. The loss of this client, or a reduction in services provided to this client, would have a material adverse effect on our business, financial condition and results of operations.

Employees

As of December 31, 2003, we had 223 employees, four of whom are executive officers.

Of our employees, as of December 31, 2003, ten were engaged in sales and marketing, 189 were engaged in client related projects and 24 were engaged in administration and management. A significant number of our management and professional employees have prior industry experience. We believe that we have been successful in attracting skilled and experienced personnel, however, competition for such personnel is intensifying. Although all of our employees are covered by confidentiality and non-competition agreements, we cannot assure you that such agreements will be enforceable. As of February 29, 2004, we have employment agreements with two of our executive officers. See Item 10. Executive Compensation. We consider relations with our employees to be good.

Risk Factors

The more prominent risks and uncertainties inherent in our business are described below. However, additional risks and uncertainties may also impair our business operations. If any of the following risks actually occur, our business, financial condition or results of operations may suffer. Investing in our common stock involves a high degree of risk. Any of the following factors could harm our business and future results of operations and you could lose all or part of your investment.

Risks Related to Our Company and Business

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

Our clients may terminate or delay their contracts for a variety of reasons, including, but not limited to:

unexpected or undesired clinical results;

the client's decision to terminate the development of a particular product or to end a particular study;

insufficient patient enrollment in a study;

insufficient investigator recruitment;

failure to perform our obligations under the contract; or

the failure of products to satisfy safety requirements.

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In addition, we believe that FDA-regulated companies may proceed with fewer clinical trials or conduct them without assistance of contract service organizations if they are trying to reduce costs as a result of cost containment pressures associated with healthcare reform, budgetary limits or changing priorities. These factors may cause such companies to cancel contracts with contract service organizations.

We cannot assure you that our clients will continue to use our services or that we will be able to replace, in a timely or effective manner, departing clients with new clients that generate comparable revenues. Further, we cannot assure you that our clients will continue to generate consistent amounts of revenues over time. We have not recently experienced cancellations or delays due to any of the factors identified above.

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 entitle us to receive all fees earned up to the time of termination. The loss of all of the business from our client NPS would have a material adverse effect on our financial condition.

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

We depend on research and development expenditures by pharmaceutical, biotechnology and medical device companies to sustain our business. Our operations could be materially and adversely affected if:

clients' businesses experience financial problems or are affected by a general economic downturn;

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

clients reduce their research and development expenditures.

Revenues from one client, NPS, encompassing four distinct projects, amounted to 14% of service revenues for the year ended December 31, 2003 and 13% of service revenues for the year ended December 31, 2002. The loss of business from a significant client or our failure to continue to obtain new business would have a material adverse effect on our business and revenues.

Our contracted/committed backlog may not be indicative of future results.

Our reported contracted/committed backlog of approximately \$41.3 million at December 31, 2003 is based on anticipated net service revenue from uncompleted projects with clients. Backlog is the amount of revenue that remains to be earned and recognized on signed and verbally agreed to contracts. Contracts included in backlog are subject to termination by our clients at any time. In the event that the client cancels a contract, we would be entitled to receive payment for all services performed up to the cancellation date. The duration of the projects included in our backlog range from less than three months to seven years. We cannot assure that this backlog will be indicative of future results. A number of factors may affect backlog, including:

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the variable size and duration of the projects (some are performed over several years);

the loss or delay of projects;

the change in the scope of work during the course of a project; and

the cancellation of such contracts by our clients.

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

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We have experienced substantial expansion in the past, and if we fail to properly manage that expansion, our business may suffer.

Our business has expanded substantially in the past. Service revenues for fiscal 2003 were \$21,747,636, an increase of approximately 26.5% over service revenues for fiscal 2002 of \$17,189,762. Our continuing sales and marketing efforts have increased the number of projects under management from 141 in 2001 to 186 in 2002. Although the number of projects under management for 2003 remained relatively constant with 2002, the value of these projects has increased and, therefore, the amount of work required has also increased. We had 223 employees in 2003 and 175 employees in 2002. Rapid expansion could strain our operational, human and financial resources. If we fail to properly manage this expansion, our results of operations and financial condition might be adversely affected. In order to manage our expansion, we must:

effectively market our services to pharmaceutical, biotechnology and medical device companies;

continue to improve operating, administrative and information systems;

accurately predict future personnel and resource needs to meet client contract commitments;

track the progress of on-going client projects; and

attract and retain qualified management, sales, professional and technical operating personnel.

We will face additional risks in expanding foreign operations. Specifically, we might find it difficult to:

assimilate differences in foreign business practices and regulations;

hire and retain qualified personnel; and

overcome language and cultural barriers.

We may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits.

We may acquire additional businesses, technologies and products if we determine that these additional businesses, technologies and products complement our existing business or otherwise serve our strategic goals. We currently have no commitments or agreements with respect to any acquisitions. If we do undertake transactions of this sort, the process of integrating an acquired business, technology or product may result in operating difficulties and expenditures and may absorb significant management attention that would otherwise be available for ongoing development of our business. Moreover, we may never realize the anticipated benefits of any acquisition. We believe that the integration associated with our acquisition of Intelligent Imaging has been substantially completed, and that we did not experience any significant difficulties in such integration. Future acquisitions could result in potentially dilutive issuances of our securities, the incurrence of debt and contingent liabilities and amortization expenses related to intangible assets, which could adversely affect our results of operations and financial condition.

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

Future success depends on the personal efforts and abilities of the principal members of our senior management to provide strategic direction, develop business, manage operations and maintain a cohesive and stable environment. Specifically, we are dependent upon Mark L. Weinstein, President and Chief Executive Officer, David A. Pitler, Senior Vice President Operations, Colin G. Miller, Ph.D., Senior Vice President Business Development and Ted I. Kaminer, Senior Vice President and Chief Financial Officer. Although we have an employment agreement with each of Mr. Weinstein and Mr. Kaminer, this does not necessarily mean that either of them will remain with us. We do not have employment agreements with any other key personnel. Furthermore, our performance also depends on our ability to attract and retain management and qualified professional and technical operating staff. Competition for these skilled personnel is intense. The loss of services

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of any key executives, or inability to continue to attract and retain qualified staff, could have a material adverse effect on our business, results of operations and financial condition. We do not maintain any key employee insurance on any of our executives.

Our revenues, earnings and operating costs are exposed to exchange rate fluctuations.

In fiscal 2003, we derived a small portion of service revenues from international operations. Our financial statements are denominated in United States dollars. In the event we derive a greater portion of our service revenues from international operations, factors associated with international operations, including changes in foreign currency exchange rates, could affect our results of operations and financial condition. Fluctuations in foreign currency exchange rates could materially impact the operating costs of our facility in the Netherlands, which are primarily EURO denominated.

Risks Related to Our Industry

Our failure to compete effectively in the competitive industry will cause our revenues to decline.

Significant factors in determining whether we will be able to compete successfully include:

consultative and clinical trials design capabilities;

reputation for on-time quality performance;

expertise and experience in specific therapeutic areas;

the scope of service offerings;

strength in various geographic markets;

the price of services;

ability to acquire, process, analyze and report data in a time-saving and accurate manner;

ability to manage large-scale clinical trials both domestically and internationally;

our size; and

the service and product offerings of our competitors.

If our services are not competitive based on these or other factors, our business, financial condition and results of operations will be materially harmed.

The biopharmaceutical services industry is highly competitive, and we face numerous competitors in our business, including hundreds of contract research organizations. If we fail to compete effectively, we will lose clients, which would cause our business to suffer. We primarily compete against in-house departments of pharmaceutical companies, full service contract research organizations, or CROs, small specialty CROs, and to a lesser extent, universities and teaching hospitals. Some of these competitors, including the in-house departments of pharmaceutical companies, have greater capital, technical and other resources than we do. In addition, certain of our competitors that are smaller specialized companies may compete effectively against us because of their concentrated size and focus.

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

Service revenues depend greatly on the expenditures made by the pharmaceutical and biotechnology industries in research and development. Accordingly, economic factors and industry trends that affect our clients in these industries also affect our business. For example, the practice of many companies in these industries has been to hire outside organizations like us to conduct clinical research projects. This practice has grown significantly in the last decade, and we have benefited from this trend. However, if this trend were to change and companies in these industries were to reduce the number of research and development projects they outsource, our business could be materially adversely affected.

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

Failure to comply with existing regulations could result in increased costs to complete clinical trials.

Our business is subject to numerous governmental regulations, primarily relating to pharmaceutical product development and the conduct of clinical trials. In particular, we are subject to 21 CFR Part 11 of the Code of Federal Regulations that provides the criteria for acceptance by the FDA of electronic records. If we fail to comply with these governmental regulations, it could result in the termination of ongoing clinical research or the disqualification of data for submission to regulatory authorities. We also could be barred from providing clinical trial services in the future or be subjected to fines. Any of these consequences would harm our reputation, our prospects for future work and our operating results.

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

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

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

In addition to healthcare reform proposals, the expansion of managed care organizations in the healthcare market may result in reduced spending on research and development. Managed care organizations' efforts to cut costs by limiting expenditures on pharmaceuticals and medical devices could result in pharmaceutical, biotechnology and medical device companies spending less on research and development. If this were to occur, we would have fewer business opportunities and our revenues could decrease, possibly materially.

Governmental agencies throughout the world, but particularly in the United States, strictly regulate the drug development/approval process. Our business involves helping pharmaceutical and biotechnology companies navigate the regulatory drug approval process. Changes in regulation, such as relaxation in regulatory requirements or the introduction of simplified drug approval procedures or an increase in regulatory requirements that we may have difficulty satisfying could eliminate or substantially reduce the need for our services. If these changes in regulations were to occur, our business, results of operations and financial condition could be materially adversely affected. These and other changes in regulation could have a material adverse impact on our available business opportunities.

If governmental agencies do not accept the data and analyses generated by our services, the need for our services would be eliminated or substantially reduced.

The success of our business is dependent upon continued acceptance by the FDA and other regulatory authorities of the data and analyses generated by our services in connection with the evaluation of the safety and efficacy of new drugs and devices. The FDA has formal guidelines that encourage the use of surrogate measures, through submission of digital image data, for evaluation of drugs to treat life-threatening or debilitating conditions. We cannot assure you that the FDA or other regulatory authorities will accept the data or analyses generated by us in the future and, even assuming acceptance, the FDA or other regulatory authorities

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may not require the application of imaging techniques to numbers of patients and over time periods substantially similar to those required of traditional safety and efficacy techniques. If the governmental agencies do not accept data and analyses generated by our services in connection with the evaluation of new drugs and devices, the need for our services would be eliminated or substantially reduced, and, as a result, our business, results of operations and financial condition could be materially adversely affected.

We may be exposed to liability claims as a result of our involvement in clinical trials.

We may be exposed to liability claims as a result of our involvement in clinical trials. We cannot assure you that liability claims will not be asserted against us as a result of work performed for our clients. We maintain liability insurance coverage in amounts that we believe are sufficient for the pharmaceutical services industry. Furthermore, we cannot assure you that our clients will agree to indemnify us, or that we will have sufficient insurance to satisfy any such liability claims. If a claim is brought against us and the outcome is unfavorable to us, such outcome could have a material adverse impact on us.

Risks related to our common stock

Your percentage ownership and voting power and the price of our common stock may decrease as a result of events that increase the number of our outstanding shares.

As of December 31, 2003, we had the following capital structure:

Common stock outstanding	10,710,481
Common stock issuable upon:	
Exercise of options which are outstanding	1,807,927
Exercise of options which have not been granted	1,542,073
Conversion of outstanding convertible note	145,068
Total common stock outstanding assuming exercise or conversion of all of the above	14,205,549

As of December 31, 2003, we had outstanding options to purchase approximately 1,807,927 shares of common stock at exercise prices ranging from \$0.63 to \$4.74 (exercisable at a weighted average of \$1.41 per share), of which approximately 1,542,579 options were then exercisable. Exercise of our outstanding options into our common stock may significantly and negatively affect the market price for our common stock as well as decrease your percentage ownership and voting power. In addition, at December 31, 2003, we had outstanding a convertible promissory note in the principal amount of \$666,664. The number of shares of common stock into which the note may be converted is calculated by dividing the outstanding principal balance of the note, plus all accrued and unpaid interest, by the greater of: (i) 75% of the average closing price of our common stock over the ten consecutive trading days ending prior to the date of conversion; or (ii) \$0.906 per share. As of December 31, 2003, the note was convertible into 145,068 shares of our common stock. Under the formula contained in the note, at the minimum price per share of \$0.906, the maximum number of shares of our common stock to be issued to Quintiles, Inc., based upon the outstanding principal amount and accrued interest at December 31, 2003, would be 741,351 shares. In addition, we may conduct future offerings of our common stock or other securities with rights to convert the securities into shares of our common stock. As a result of these and other events that increase the number of our outstanding shares, your percentage ownership and voting power and the price of our common stock may decrease.

Shares of our common stock eligible for public sale may have a negative impact on its market price.

Future sales of shares of our common stock by existing holders of our common stock or by holders of outstanding options, upon the exercise thereof, could have a negative impact on the market price of our common stock. As of December 31, 2003, we had 10,710,481 shares of our common stock issued and outstanding. Of this amount, 6,404,932 are freely tradable and 4,305,549 are registered on a Form S-3 with the Securities and Exchange Commission.

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We are unable to estimate the number of shares that may be sold since this will depend on the market price for our common stock, the personal circumstances of the sellers and other factors. Any sale of substantial amounts of our common stock or other securities in the open market may adversely affect the market price of the securities offered hereby and may adversely affect our ability to obtain future financing in the capital markets as well as create a potential market overhang.

Our affiliates have significant control over our common stock, allowing them to have significant influence over the outcome of all matters submitted to our stockholders for approval, which influence may conflict with our interests and the interests of our other stockholders.

Our directors, officers and principal stockholders, including Covance Inc., Quintiles, Inc. and certain of their affiliates, beneficially owned approximately 37% of the outstanding shares of common stock on a fully diluted as-converted to common stock basis at December 31, 2003, and such stockholders will have significant influence over the outcome of all matters submitted to our stockholders for approval, including the election of our directors and other corporate actions. In addition, such influence by these affiliates could have the effect of discouraging others from attempting to take us over, thereby increasing the likelihood that the market price of the common stock will not reflect a premium for control.

Because we do not intend to pay dividends, stockholders will benefit from an investment in our common stock only if it appreciates in value.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain our future earnings, if any, to finance further research and development and do not expect to pay any cash dividends in the foreseeable future. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

Our earnings may be adversely affected if we change our accounting policy with respect to employee stock options.

Stock options are an important component of compensation packages for most of our mid- and senior-level employees. We currently do not deduct the expense of employee stock option grants from our income. Many companies, however, are considering a change to their accounting policies to record the value of stock options issued to employees as an expense and changes in the accounting treatment of stock options are currently under consideration by the Financial Accounting Standards Board and other accounting standards-setting bodies. If we were to change our accounting policy with respect to the treatment of employee stock option grants, our earnings could be materially adversely affected. For example, if we applied the fair value recognition provisions under consideration, our net income for fiscal 2003 would have been \$1,533,767, as compared to the reported net income of \$2,337,853, and our net income for fiscal 2002 would have been \$935,360, as compared to the reported net income of \$1,139,837.

Trading in our common stock may be volatile, which may result in substantial declines in its market price.

The market price of our common stock has experienced historical volatility and might continue to experience volatility in the future in response to quarter-to-quarter variations in:

operating results;

analysts' reports;

market conditions in the industry;

changes in governmental regulations; and

changes in general conditions in the economy or the financial markets.

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The market has also experienced significant decreases in value. This volatility and the recent market decline has affected the market prices of securities issued by many companies, often for reasons unrelated to their operating performance, and may adversely affect the price of our common stock. Between January 1, 2003 and December 31, 2003, our common stock has traded at a low of \$2.15 per share and a high of \$8.10 per share.

Our common stock began trading on the NASDAQ National Market on December 18, 2003 and has a limited trading market. Prior to that time, our common stock was trading on the American Stock Exchange since February 2003. We cannot assure that an active trading market will develop or, if developed, will be maintained. As a result, our stockholders may find it difficult to dispose of shares of our common stock and, as a result, may suffer a loss of all or a substantial portion of their investment.

Certain provisions of our charter and Delaware law could make a takeover difficult and may prevent or frustrate attempts by our stockholders to replace or remove our management team.

We have an authorized class of 1,750,000 shares of undesignated preferred stock that may be issued by our board of directors, on such terms and with such rights, preferences and designation as the Board may determine. Issuance of such preferred stock, depending upon the rights, preferences and designations thereof, may have the effect of delaying, deterring or preventing a change in control of us. In addition, we are subject to provisions of Delaware corporate law which, subject to certain exceptions, will prohibit us from engaging in any business combination with a person who, together with affiliates and associates, owns 15% or more of our common stock for a period of three years following the date that the person came to own 15% or more of our common stock unless the business combination is approved in a prescribed manner.

These provisions of our certificate of incorporation, and of Delaware law may have the effect of delaying, deterring or preventing a change in control of our company, may discourage bids for our common stock at a premium over market price and may adversely affect the market price, and the voting and other rights of the holders, of our common stock. In addition, these provisions make it more difficult to replace or remove our current management team in the event our stockholders believe this would be in the best interest of our company and our stockholders.

Item 2. Properties.

We lease approximately 31,500 square feet of office space located in Newtown, Pennsylvania. This lease expires June 2010 and provides for a fixed base rent of approximately \$52,000 per month with an annual inflation increase. We lease approximately 5,000 square feet of additional office space located in Newtown, Pennsylvania for approximately \$4,000 per month in base rent expiring November 2005. We are also subleasing office space in Newtown, Pennsylvania for monthly fixed base rents of approximately \$9,000 for approximately 6,000 square feet and approximately \$4,500 for approximately 2,400 square feet. The subleases expire in April 2004 and August 2006. We are currently negotiating an extension of these subleases to June 2010, to coincide with the expiration of the lease of our headquarters. In addition, we lease approximately 9,000 square feet of office space in Leiden, the Netherlands. This lease, denominated in EURO, expires in April 2008 and provides for a base rent of approximately \$20,677, based upon the conversion rate as of December 31, 2003, per month with an annual inflation increase. We believe that these facilities will be adequate for our needs for the foreseeable future.

Item 3. Legal Proceedings.

In the normal course of business, we may be a party to legal proceedings. We are not currently a party to any material legal proceedings.

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

None.

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Our common stock began trading on the NASDAQ National Market on December 18, 2003 under the symbol BITI. Prior to listing on the NASDAQ National Market, our common stock was traded on the American Stock Exchange under the symbol BIT from February 25, 2003. Our common stock was quoted on the NASD OTC Bulletin Board under the symbol BITI prior to being listed on the American Stock Exchange.

The following table sets forth the high and low bid quotations for our common stock as reported on the NASDAQ National Market for the quarter ended December 31, 2003. Such quotations reflect interdealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

Quarter Ended	Common Stock	
	High	Low
December 31, 2003 (December 18, 2003 – December 31, 2003)	6.75	5.60

The following table sets forth the high and low sales prices for our common stock as reported on the American Stock Exchange for each of the quarters from the quarter ended March 31, 2003 through December 31, 2003.

Quarter Ended	Common Stock	
	High	Low
March 31, 2003	3.95	2.15
June 30, 2003	6.30	3.02
September 30, 2003	8.10	5.10
December 31, 2003 (October 1, 2003 – December 17, 2003)	7.35	5.41

The following table sets forth the high and low bid quotations for our common stock as reported on the NASD OTC Bulletin Board for each of the quarters from the quarter ended March 31, 2002 through December 31, 2002. Such quotations reflect interdealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

Quarter	Common	
	Stock	
Ended	High	Low
March 31, 2002	1.51	1.08
June 30, 2002	1.71	1.16
September 30, 2002	2.15	1.18
December 31, 2002	2.45	1.55

Our common stock was also previously listed on the Boston Stock Exchange under the symbol BIT, but it was not traded during each of the quarters from the quarter ended March 31, 2002 through March 31, 2003. As a result of our listing of our common stock on the American Stock Exchange, we removed our common stock listing from the Boston Stock Exchange.

As of April 18, 2003, the approximate number of holders of record of our common stock was 117 and the approximate number of beneficial holders of our common stock was 1,700.

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On September 15, 2003, we consummated a private placement of 1,762,000 shares of our common stock to certain institutional investors at a purchase price of \$6.125 per share, for an aggregate investment of \$10,792,250. C.E. Unterberg, Towbin and Emerging Growth Equities Ltd. acted as our placement agents for this offering. We agreed to pay the placement agents cash commissions equal to 6% of the gross proceeds of this offering and a 1% non-accountable expense allowance. We expect to use the net proceeds received from this financing of \$9,874,250 for general corporate purposes, including working capital and capital expenditures, and for possible acquisitions. These securities have been registered with the Securities and Exchange Commission.

In November 2003, in connection with the CapMed acquisition, we paid total consideration to CapMed of \$550,000, consisting of \$211,828 in cash paid directly to CapMed's creditors and \$338,171 of our common stock, which amounted to a total of 51,724 shares, of which 40,361 were issued to CapMed and 11,363 were issued to an escrow agent pursuant to the terms of the acquisition.

We did not employ an underwriter in connection with the issuance of the securities described above. We believe that the issuance of the foregoing securities was exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as transactions not involving a public offering. Each of the recipients acquired the securities for investment purposes only and not with a view to distribution and had adequate information about our company.

We have neither paid nor declared dividends on our common stock since our inception and do not plan to pay dividends on our common stock in the foreseeable future. We expect that any earnings which we may realize will be retained to finance our growth.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are a pharmaceutical contract service organization, providing services that support the product development process of the pharmaceutical, biotechnology and medical device industries. We specialize in assisting our clients in the design and management of the medical-imaging component of clinical trials for all imaging modalities, including computerized tomography, magnetic resonance imaging, x-rays, dual energy x-ray absorptiometry, position emission tomography, single photon emission computerized tomography and ultrasound. We provide services that include the processing and analysis of medical images and the data-basing and regulatory submission of medical images, quantitative data and text. We also offer a service called Bio-Imaging ET&CSM, which focuses on education, training and certification for medical imaging equipment, facilities and staff.

Our sales cycle, referring to the period from the presentation by us to a potential client to the engagement of us by such client, has historically been approximately 12 months. In addition, the contracts under which we perform services typically cover a period of 12 to 60 months and the volume and type of services performed by us generally vary during the course of a project. We cannot assure you that our project revenues will remain at levels sufficient to maintain profitability. Service revenues were generated from 68 clients encompassing 184 distinct projects for fiscal 2003. This compares to 67 clients encompassing 186 distinct projects for fiscal 2002. The relatively constant number of projects is primarily due to our sales and marketing efforts being focused on larger average value contracts.

Our contracted/committed backlog, referred to as backlog, is the amount of service revenue that remains to be earned and recognized on both signed and verbally agreed to contracts. Our backlog was approximately \$41.3 million as of December 31, 2003. This compares to

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approximately \$36.5 million as of December 31, 2002, an increase of 13.2%. Contracts included in backlog are subject to termination by our clients at any time. In the event that a contract is cancelled by the client, we would be entitled to receive payment for all services performed up to the cancellation date. The duration of the projects included in our backlog range from less than 3 months to 7 years. We believe that our backlog assists our management as an indicator of our long-term business. However,

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we do not believe that backlog is a reliable predictor of near-term results because service revenues may be incurred in a given period on contracts that were not included in the previous reporting period's backlog and/or contract cancellations may occur in a given period on contracts that were included in the previous reporting period's backlog.

We believe that demand for our services and technologies will continue to grow as the use of digital technologies for data acquisition and management increases in the radiology and drug development communities. We also believe that there is a growing recognition within the bio-pharmaceutical industry of the advantages in using an independent centralized core laboratory for analysis of medical-imaging data and compliance with the regulatory demands for the submission of such data. In addition, the FDA is gaining experience with electronic submissions and is continuing to develop sophisticated guidelines for computerized submission of clinical trial data, including medical images. Furthermore, the increased use of digital medical images in clinical trials, especially for important drug classes such as anti-inflammatory, neurologic and oncologic therapeutics and diagnostic image agents, generate large amounts of image data from a large number of imaging sources. These studies require processing, analysis, data management and submission services best handled by vendors with scalable logistical capabilities and extensive experience working with research facilities worldwide. Due to several factors, including, without limitation, competition from commercial competitors and academic research centers, we cannot assure you that demand for our services and technologies will grow, sustain growth, or that additional revenue generating opportunities will be realized by us.

In November 2003, we acquired the intellectual property of CapMed Corporation, located in Wilmington, Delaware, referred to as CapMed, including the Personal Health Record software, referred to as PHR, and the patent-pending Personal HealthKey technology. The PHR is a software application that enables users to manage and store personal health information, including their medical images, on the privacy of their desktop computer, while linking directly to sponsor-directed resources such as drug information, patient education, or disease guidelines. The Personal HealthKey plugs into a computer's USB port, allowing doctors and patients easy access to the patient's medical record without the need for additional hardware or software, and it is password protected. The negotiations between us and CapMed were conducted on an arms-length basis. In connection with the acquisition, CapMed received aggregate consideration of \$550,000, consisting of \$211,828 in cash paid directly to CapMed's creditors and \$338,171 of our common stock, which amounted to a total of 51,724 shares, of which 40,361 were issued to CapMed and 11,363 were issued to an escrow agent pursuant to the terms of the acquisition.

Certain matters discussed in this Form 10-KSB are forward-looking statements intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as believes, expects, may, will, should, or anticipates or the negative thereof or other variations thereof, comparable terminology, or by discussions of strategy that involve risks and uncertainties. In particular, our statements regarding the demand for our services and technologies, growing recognition for the use of independent centralized core laboratories, trends toward the outsourcing of imaging services in clinical trials, realized return from our marketing efforts and increased use of digital medical images in clinical trials are examples of such forward-looking statements. The forward-looking statements include risks and uncertainties, including, but not limited to, the timing of revenues due to the variability in size, scope and duration of projects, estimates made by management with respect to our critical accounting policies, regulatory delays, clinical study results which lead to reductions or cancellations of projects, and other factors, including general economic conditions and regulatory developments, not within our control. The factors discussed in this Form 10-KSB and expressed from time to time in our filings with the Securities and Exchange Commission could cause actual results and developments to be materially different from those expressed in or implied by such statements. The forward-looking statements are made only as of the date of this filing and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.

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Critical Accounting Policies, Estimates and Risks

Financial Reporting Release No. 60, was issued by the Securities and Exchange Commission, requiring all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. The notes to the consolidated financial statements includes a summary of significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. The following is a brief discussion of the more significant accounting policies and methods used us.

In addition, Financial Reporting Release No. 61 was recently released by the SEC to require all companies to include a discussion to address, among other things, liquidity, off-balance sheet arrangements, contractual obligations and commercial commitments.

Our discussion and analysis of our financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in accordance with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the recoverability of tangible and intangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period.

On an on-going basis, we evaluate our estimates. The most significant estimates relate to the recognition of revenue and profits based on the proportional performance method of accounting for fixed service contracts, allowance for doubtful accounts and income taxes.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition. Service revenues are recognized over the contractual term of our customer contracts using the proportional performance method, which is based on hours incurred as a percentage of total estimated hours. Service revenues are first recognized when we have a signed contract from a customer which: (i) contains fixed or determinable fees; and (ii) collectability of such fees is reasonably assured. Any change to recognized service revenue as a result of revisions to estimated total hours are recognized in the period the estimate changes. Our revenue recognition policy entails a number of estimates including an estimate of the total hours that are expected to be incurred on a project, which is used as the basis for determining the portion of our revenue to be recognized for each period. The revenue recognized in any period might have been materially affected if different assumptions or conditions prevailed. The timing of our recognition of revenue would be revised if there were changes in the total estimated hours (other than scope changes in a project which typically result in a revision to the contract). We review our total estimated hours monthly.

We enter into contracts that contain fixed or determinable fees. The fees in the contracts are based on the scope of work we are contracted to perform; there are unitized fees per service and fixed fees with a total estimated for the contract based upon the estimated unitized service expected to be performed, as well as the service to be delivered under the fixed fee component of the contract. The units are estimated based on the information provided by the customer, and we bill the customer for actual units completed in accordance with the terms of the contract.

We also incur direct costs at the outset of a customer service arrangement prior to receiving a final signed contract. Accordingly, we defer these costs and delay the recording of any revenue until the contract is executed. If a customer does not execute the contract, we would immediately expense the deferred costs, which would reduce net income in the period that the customer terminated the relationship, offset by any service

revenue associated with these costs.

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts on a specific identification method for estimated losses resulting from the inability of our customers to make required payments. If the

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financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required, which would reduce our net income in the period that we determine that the additional allowances are needed.

Income Taxes. We record a valuation allowance to reduce our deferred tax assets to an amount that is more likely than not to be realized. In assessing the need for the valuation allowance, we consider our future taxable income and on-going prudent and feasible tax planning strategies. In the event that we were to determine that, in the future, we would be able to realize our deferred tax assets in excess of its net recorded amount, an adjustment to the deferred tax asset would be made, thereby increasing net income in the period such determination was made. Likewise, should we determine that it is more likely than not that we will be unable to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged, thereby decreasing net income in the period such determination was made. We recognize contingent liabilities for any tax related exposures when those exposures are both probable and estimable.

Results of Operations*Fiscal Years Ended December 31, 2003 and 2002*

	2003	% of Total Revenue	2002	% of Total Revenue	\$ Change	% Change
Service revenues	\$ 21,747,636	87.1%	\$ 17,189,762	84.0%	\$ 4,557,874	26.5%
Reimbursement revenues	\$ 3,223,548	12.9%	\$ 3,278,319	16.0%	\$ (54,771)	(1.7)%
Total revenues	\$ 24,971,184	100.0%	\$ 20,468,081	100.0%	\$ 4,503,103	22.0%
Cost of revenues	\$ 16,635,643	66.6%	\$ 14,089,801	68.8%	\$ 2,454,842	17.4%
General and administrative expenses	\$ 4,079,419	16.3%	\$ 3,098,388	15.1%	\$ 981,031	31.7%
Sales and marketing expenses	\$ 2,057,878	8.2%	\$ 1,728,945	8.4%	\$ 328,933	19.0%
Total costs and expenses	\$ 22,772,940	91.2%	\$ 18,917,134	92.4%	\$ 3,855,806	20.4%
Income from operations	\$ 2,198,244	8.8%	\$ 1,550,947	7.6%	\$ 647,297	41.7%
Interest expense - net	\$ 130,655	0.5%	\$ 122,175	0.6%	\$ 8,480	6.9%
Income before income tax	\$ 2,067,589	8.3%	\$ 1,428,772	7.0%	\$ 638,817	44.7%
Income tax (benefit) provision	\$ (270,264)	(1.1)%	\$ 288,935	1.4%	\$ (559,199)	(193.5)%
Net income	\$ 2,337,853	9.4%	\$ 1,139,837	5.6%	\$ 1,198,016	105.1%

Service revenues was \$21,747,636 for fiscal 2003 and \$17,189,762 for fiscal 2002, an increase of \$4,557,874 or 26.5%. The increase in service revenues was due to an increase in the dollar value of projects resulting from the overall market growth for medical imaging related services for clinical trials and what we believe to be our increasing market share.

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Service revenues were generated from 68 clients encompassing 184 distinct projects for fiscal 2003. This compares to 67 clients encompassing 186 distinct projects for fiscal 2002. The decrease in the number of projects is primarily due to our sales and marketing efforts being focused on larger average value contracts. One client, NPS, encompassing four projects represented 14.0% of our service revenues for fiscal 2003, while for the comparable period last year, one client, NPS, encompassing four projects represented 13.0% of our service revenues. No other client accounted for more than 10% of service revenues. Service revenues generated from our client base, while still concentrated as measured by the number of clients, has continued to become more dispersed over time, and we believe more diversification is evident when revenue concentration is measured by the number of individual projects. Our primary scope of work in both periods included medical-imaging core laboratory services and image-based information management services.

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Reimbursement revenues consist of pass-through costs reimbursed by the customer. Reimbursement revenues fluctuate significantly over the course of any given project and quarter to quarter variations are a reflection of this project timing. Therefore, our management believes that reimbursement revenues are not a significant indicator of our overall performance trends.

Cost of revenues was \$16,635,643 for fiscal 2003 and \$14,089,801 for fiscal 2002, an increase of \$2,454,842 or 17.4%. Cost of revenues for fiscal 2003 and 2002 was comprised of professional salaries and benefits, allocated overhead and pass-through costs. The increase in cost of revenues is primarily attributable to an increase in staffing levels required for project related tasks for fiscal 2003. We expect that our cost of revenues will continue to increase in fiscal 2004 as revenue increases.

The decrease in cost of revenues as a percentage of total revenues to 66.6% for fiscal 2003 from 68.8% for fiscal 2002 is primarily attributable to our increase in total revenues with a lesser increase in costs associated with project related costs. The cost of revenues as a percentage of total revenues also fluctuates due to work-flow variations in the utilization of staff and the mix of services provided by us in any given period.

General and administrative expenses was \$4,079,419 for fiscal 2003 and \$3,098,388 for fiscal 2002, an increase of \$981,031 or 31.7%. General and administrative expenses in fiscal 2003 and 2002 consisted primarily of professional salaries and benefits, depreciation and amortization, professional and consulting services, office rent and corporate insurance. The increase in general and administrative expenses is primarily attributable to an increase in personnel and professional services, with approximately 70% of the increase attributable to an increase in personnel, including the addition of certain management positions, to support the growth in our service revenues, and approximately 30% of the increase attributable to an increase in professional services associated with general corporate matters including increased legal, accounting, and regulatory compliance demands on public companies. We expect that our general and administrative expenses will continue to increase in fiscal 2004 as revenue increases.

The increase in general and administrative expenses as a percentage of total revenues to 16.3% for fiscal 2003 from 15.1% for fiscal 2002 is primarily due to an increase in personnel to support the growth in our service revenues as well as an increase in our professional service fees.

Sales and marketing expenses was \$2,057,878 for fiscal 2003 and \$1,728,945 for fiscal 2002, an increase of \$328,933 or 19.0%. Sales and marketing expenses in fiscal 2003 and 2002 were comprised of direct sales and marketing costs, professional salaries and benefits and allocated overhead. The increase in sales and marketing expenses is primarily attributable to higher salaries and sales commission commensurate with the increase in service revenue during this period, increased trade show attendance and increased marketing expenses, with approximately 28% of the increase attributable to the higher salaries and sales commission, approximately 7% of the increase attributable to the increase in trade show attendance and approximately 16% of the increase attributable to the increase in marketing expenses. We expect that sales and marketing expenses will increase in fiscal 2004 as we continue to expand our market presence in the United States and Europe.

Sales and marketing expenses as a percentage of total revenues of 8.2% for fiscal 2003 and 8.4% for fiscal 2002, essentially did not fluctuate.

Net interest expense was \$130,655 for fiscal 2003 and \$122,175 for fiscal 2002, an increase of \$8,480 or 6.9%. This increase is primarily due to interest expense incurred on additional equipment lease obligations, offset by more interest income on a higher cash balance, in fiscal 2003. Net interest expense for fiscal 2003 and 2002 resulted from interest expense incurred on equipment lease obligations and the promissory note issued by us to Quintiles, Inc., referred to as the Quintiles Note.

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Income before income taxes was \$2,067,589 for fiscal 2003 and \$1,482,772 for fiscal 2002, an increase of \$584,817 or 39.4%. This increase in income before income taxes for fiscal 2003 was attributable to the increased revenues associated with an increase in services performed on projects for which we were contracted offset, in

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part, by the costs associated with increased staffing levels necessary to perform the newly contracted services. The increase in income before income taxes as a percentage of total revenues to 8.3% for fiscal 2003 from 7.0% for fiscal 2002 is primarily due to increased revenues associated with an increase in services performed on projects for which we were contracted with a lesser increase in costs of revenue as a percentage of total revenues for fiscal 2003. We believe that both the presentation of a comparison of income before income taxes for fiscal 2003 and fiscal 2002 and the presentation of income before income taxes as a percentage of total revenues for fiscal 2003 and fiscal 2002 provide useful information to investors regarding our financial condition and results of operations because they exclude the income tax benefit of \$270,264 in fiscal 2003 and the income tax provision of \$288,935 in fiscal 2002, which will not be applicable in future periods.

Our income tax benefit for fiscal 2003 was \$270,264 versus an income tax provision of \$288,935 in fiscal 2002. The income tax benefit in fiscal 2003 resulted from recording a deferred tax benefit for the future tax savings anticipated from using the net operating loss carryforwards available at December 31, 2003. As a result, we believe our effective income tax rate will be approximately 40% for fiscal 2004.

Net income was \$2,337,853 for fiscal 2003 and \$1,139,837 for fiscal 2002, an increase of \$1,198,016 or 105.1%. This increase in net income for fiscal 2003 was attributable to the increased revenues associated with an increase in services performed on projects for which we were contracted offset, in part, by the costs associated with increased staffing levels necessary to perform the newly contracted services and \$270,264 income tax benefit in fiscal 2003 as compared to an income tax provision of \$288,935 in fiscal 2002.

The increase in net income as a percentage of total revenues to 9.4% for fiscal 2003 from 5.6% for fiscal 2002 is primarily due to the income tax benefit in fiscal 2003 as compared to the income tax provision in fiscal 2002.

Liquidity and Capital Resources

	<u>2003</u>	<u>2002</u>
Net cash provided by operating activities	\$ 2,887,619	\$ 3,502,950
Net cash used in investing activities	\$ (1,914,223)	\$ (991,979)
Net cash provided by (used in) financing activities	\$ 9,752,791	\$ (447,415)

At December 31, 2003, we had cash and cash equivalents of \$13,289,453. Working capital at December 31, 2003 was \$12,965,887.

Net cash provided by operating activities of \$2,887,619 for fiscal 2003 was due to net income for the period, an adjustment to reflect \$1,075,742 of non-cash depreciation and amortization, an adjustment of (\$418,965) for the benefit for deferred income taxes and changes in certain assets and liabilities, such as, an increase in accrued expenses and other current liabilities of \$273,973 in fiscal 2003 versus an increase of \$918,994 in fiscal 2002 primarily due to accruals for compensation and consulting fees that were not paid at December 31, 2002. This was offset by a decrease in deferred revenue of \$194,301 in fiscal 2003 as compared to an increase of \$1,552,688 in fiscal 2002 due to lesser up-front deposits received upon contract signings.

Net cash used in investing activities primarily represents our investment in capital and leasehold improvements. We currently anticipate that capital expenditures for fiscal 2004 will be approximately \$1,400,000. These expenditures represent additional upgrades in our networking, data storage and core laboratory capabilities for both the United States and European operations.

Net cash provided by financing activities is primarily attributable to \$9,874,250 of net proceeds from the issuance of 1,762,000 shares of our common stock in a private placement to certain institutional investors on September 15, 2003 at a price of \$6.125 per share.

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The following table lists our cash contractual obligations as of December 31, 2003:

Contractual obligations	Payments Due By Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt obligations					
Capital lease obligations	\$ 1,386,035	\$ 615,333	\$ 770,702		
Facility rent operating leases	\$ 5,560,985	\$ 966,866	\$ 2,757,601	\$ 1,479,523	\$ 356,995
Purchase obligations					
Employment agreements	\$ 487,500	\$ 450,000	\$ 37,500		
Quintiles note	\$ 666,664	\$ 666,664			
Total contractual cash obligations	\$ 8,101,184	\$ 2,698,863	\$ 3,565,803	\$ 1,479,523	\$ 356,995

On May 9, 2003, we renewed and amended our agreement with Wachovia Bank, National Association. The renewed and amended agreement is for a committed line of credit of \$2,000,000, collateralized by our personal property. Interest is payable at Wachovia Bank's prime rate. The agreement requires us, among other things, to maintain a debt service coverage ratio not less than 1.25 to 1.00, measured annually and a liquidity ratio of not less than 2.00 to 1.00 at all times. The committed line of credit matures June 30, 2004 and may be renewed on an annual basis. At December 31, 2003, we had no borrowings under the committed line of credit and are compliant with the debt covenants.

In connection with our acquisition of Intelligent Imaging, as of February 1, 2002, we are obligated to pay quarterly payments of principal of \$41,667 under the Quintiles Note, plus accrued interest thereon, and one payment of principal of \$500,000 on November 1, 2004, unless the Quintiles Note is previously converted into shares of our common stock. The Quintiles Note bears interest at the rate in effect on the business day immediately prior to the date on which payments are due under the Quintiles Note equal to the three-month LIBOR as published from time to time in the Wall Street Journal plus 3%, compounded annually based on a 365-day year. We have recorded the balance of the Quintiles Note at December 31, 2003 of \$666,664 as a current liability.

On September 15, 2003, we consummated a private placement of 1,762,000 shares of our common stock to certain institutional investors at a purchase price of \$6.125 per share, for an aggregate investment of \$10,792,250. C.E. Unterberg, Towbin and Emerging Growth Equities Ltd. acted as our placement agents for this offering. We agreed to pay the placement agents cash commissions equal to 6% of the gross proceeds of this offering and a 1% non-accountable expense allowance. We expect to use the net proceeds received from this financing of \$9,874,250 for general corporate purposes, including working capital and capital expenditures, and for possible acquisitions.

These securities have been registered with the Securities and Exchange Commission.

In November 2003, in connection with the CapMed acquisition, we paid total consideration to CapMed of \$550,000, which consisted of \$211,828 of cash paid to CapMed's vendors and \$338,171 of equity issued to CapMed.

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We have neither paid nor declared dividends on our common stock since our inception and do not plan to pay dividends on our common stock in the foreseeable future.

We have not entered into any off-balance sheet transactions, arrangements or other relationships with unconsolidated entities or other persons.

We anticipate that our existing capital resources together with cash flow from operations and borrowing capacity under the existing line of credit, will be sufficient to meet our foreseeable cash needs. However, we cannot assure you that our operating results will continue to achieve profitability on an annual basis in the future. The inherent operational risks associated with:

our ability to gain new client contracts;

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the variability of the timing of payments on existing client contracts; and

other changes in our operating assets and liabilities

may have a material adverse affect on our future liquidity.

We may seek to raise additional capital from equity or debt sources in order to take advantage of unanticipated opportunities, such as more rapid expansion, acquisitions of complementary businesses or the development of new services. We cannot assure you that additional financing will be available, if at all, on terms acceptable to us.

Our fiscal 2004 operating plan contains assumptions regarding revenue and expenses. The achievement of our operating plan depends heavily on the timing of work performed by us on existing projects and our ability to gain and perform work on new projects. Project cancellation, or delays in the timing of work performed by us on existing projects or our inability to gain and perform work on new projects could have an adverse impact on our ability to execute our operating plan and maintain adequate cash flow. In the event actual results do not meet the operating plan, our management believes it could execute contingency plans to mitigate these effects. Our plans include additional financing, to the extent available, through the line of credit discussed above. Considering the cash on hand and based on the achievement of the operating plan and management's actions taken to date, management believes it has the ability to continue to generate sufficient cash to satisfy our operating requirements in the normal course of business for at least the next 12 months and the foreseeable future.

Existing Contracts

During fiscal 2003, we signed approximately \$27,100,000 in new project contracts as compared to approximately \$26,600,000 for the same period in the prior year. As of December 31, 2003, we had entered into agreements with 62 companies, encompassing 146 projects, to provide services in the aggregate amount of approximately \$62,900,000 through July 2009, of which services valued at approximately \$41,300,000 remain to be completed. Such contracts are subject to termination by us or our clients at any time or for any reason. In addition, clients' clinical trials or other projects are subject to timing and scope changes. Therefore, future revenue generated by us may not equal initial contract values.

Disclosure About Market Risk

Interest Rate Risk

We invest in high-quality financial instruments, primarily money market funds, federal agency notes, asset backed securities, corporate debt securities and United States treasury notes, with an effective duration of the portfolio of less than nine months and no security with an effective duration in excess of two years, which we believe are subject to limited credit risk. We currently do not hedge our interest rate exposure. Due to the short-term nature of our investments, we do not believe that we have any material exposure to interest rate risk arising from our investments.

Foreign Currency Risk

Our financial statements are denominated in United States dollars, and we currently do not hedge our exchange rate exposure. Fluctuations in foreign currency exchange rates could materially increase the operating costs of our facility in the Netherlands, which are primarily EURO denominated. If the exchange rate undergoes a change of 10%, we believe that it would have a material impact on our results of operations due to the increased cost of our Netherlands facility. In addition, one of our contracts is denominated in foreign currency. We believe that any adverse fluctuation in the foreign currency markets relating to this contract will not result in any material adverse effect on our financial condition or results of operations. In the event we derive a greater portion of our service revenues from international operations, factors associated with international operations, including changes in foreign currency exchange rates, could affect our results of operations and financial condition.

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Item 7. Financial Statements.

The financial statements required to be filed pursuant to this Item 7 are included in this Annual Report on Form 10-KSB. A list of the financial statements filed herewith is found at Item 13. Exhibits, List, and Reports on Form 8-K.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 8A. Controls and Procedures.

Evaluation of disclosure controls and procedures. Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Exchange Act) as of a date within 90 days of the filing date of this Annual Report on Form 10-KSB, our president and chief executive officer (principal executive officer) and our chief financial officer (principal accounting and financial officer) have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are operating in an effective manner.

Changes in internal controls. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of our most recent evaluation.

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PART III

Item 9. Directors and Executive Officers.

The information relating to our directors, nominees for election as directors and executive officers under the headings "Election of Directors" and "Executive Officers" in our definitive proxy statement for the 2004 Annual Meeting of Stockholders is incorporated herein by reference to such proxy statement.

We have adopted a written code of business conduct and ethics that applies to our principal executive officer and principal financial and accounting officer, or persons performing similar functions. We intend to disclose any amendments to, or waivers from, our code of business conduct and ethics that are required to be publicly disclosed pursuant to rules of the Securities and Exchange Commission and the NASDAQ National Market by filing such amendment or waiver with the Securities and Exchange Commission.

Item 10. Executive Compensation.

The discussion under the heading "Executive Compensation" in our definitive proxy statement for the 2004 Annual Meeting of Stockholders is incorporated herein by reference to such proxy statement.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The discussion under the heading "Security Ownership of Certain Beneficial Owners and Management" in our definitive proxy statement for the 2004 Annual Meeting of Stockholders is incorporated herein by reference to such proxy statement.

Item 12. Certain Relationships and Related Transactions.

The discussion under the heading "Certain Relationships and Related Transactions" in our definitive proxy statement for the 2004 Annual Meeting of Stockholders is incorporated herein by reference to such proxy statement.

Item 13. Exhibits, List, and Reports on Form 8-K.

(a) (1) Financial Statements.

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Reference is made to the Index to Financial Statements on Page F-1.

(a) (2) Financial Statement Schedules.

None.

(a) (3) Exhibits.

Reference is made to the Index to Exhibits on Page 27.

(b) Reports on Form 8-K.

Report on Form 8-K furnished on November 15, 2003 (reporting our financial results for the quarter ended September 30, 2003, including our unaudited financial statements).

Report on Form 8-K filed on December 12, 2003 (reporting that our common stock has been approved for quotation on the NASDAQ National Market).

Report on Form 8-K filed on January 5, 2004 (reporting that certain directors have entered into Rule 10b5-1 trading plans).

Report on Form 8-K furnished on February 4, 2004 (reporting financial results for the fourth quarter and year ended December 31, 2003).

Item 14. Principal Accountant Fees and Services.

The discussion under the heading "Principal Accountant Fees and Services" in our definitive proxy statement for the 2004 Annual Meeting of Stockholders is incorporated herein by reference to such proxy statement.

Net increase (decrease) in cash and cash equivalents

\$

13,795

\$

(5,122

)

Cash and cash equivalents:

Beginning

2,572

14,172

Ending

\$

16,367

\$

9,050

Supplemental Disclosures of Cash Flow Information

Cash payments for:

Interest paid

\$

1,270

\$

1,654

Income taxes

\$

6,819

\$

1,878

(1) See Note 3 for further discussion on the revised disclosure of discontinued operations.
See accompanying notes to unaudited condensed consolidated financial statements.

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The interim condensed consolidated financial statements of Shenandoah Telecommunications Company and Subsidiaries (collectively, the Company) are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the interim results have been reflected therein. All such adjustments were of a normal and recurring nature. These statements should be read in conjunction with the consolidated financial statements and related notes in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The balance sheet information at December 31, 2005 was derived from the audited December 31, 2005 consolidated balance sheet.

2. The Company s financial statements as of and for the years ended December 31, 2004 and 2003, including the beginning retained earnings for the year ended December 31, 2003, all quarters in 2004 and the first three quarters of the year ended December 31, 2005, were restated to correct errors relating to the Company s accounting for operating leases. While management believes that the impact of this error is not material to any previously issued financial statements, it determined that the cumulative adjustment required to correct this error was too large to record in 2005. The restated annual financial statements were included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

The Company s method of accounting for operating leases did not comply with the requirements of SFAS No. 13, Accounting for Leases and FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases. Historically, the Company has not assumed the exercise of available renewal options in accounting for operating leases. The Company has operating leases, primarily for cell sites owned by third parties, land leases for towers owned by the Company and leases with third parties for space on the Company s towers that have escalating rentals during the initial lease term and during succeeding optional renewal periods. In light of the Company s investment in each site, including acquisition costs and leasehold improvements, the Company determined that the exercise of certain renewal options was reasonably assured at the inception of the leases. Accordingly, the Company corrected its accounting to recognize rent expense on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Where the Company is the lessor, it recognizes revenue on a straight-line basis over the current term of the lease.

The impact of these restatements to the Company s statement of income for the three and six months ended June 30, 2005, was a decrease to net income of \$58 thousand and \$112 thousand, respectively. The impact associated with correcting the Company s accounting for operating leases was an increase to lease expense of \$92 thousand and \$179 thousand, respectively, reflected in Cost of goods and services and a reduction in lease income of \$7 thousand and \$12 thousand, respectively, reflected in Operating revenues. The adjustments do not affect historical net cash flows from operating, investing or financing activities, future cash flows or the timing of payments under related leases.

In the Reclassifications column, in the tables presented below, certain amounts reported in prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders equity.

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The reclassification and restatement adjustments to amounts previously presented in the consolidated statements of income are summarized below (in thousands except per share data):

Three Months Ended June 30, 2005

	Reported	Reclassifications	Restatement Adjustments	Restated
Operating revenues	\$ 35,464	\$	\$ (7)	\$ 35,457
Cost of goods and services	5,674	9,189	92	14,955
Network operating costs	10,209	(10,209)		
Selling, general and administrative	9,430	1,109		10,539
Depreciation and amortization	5,492			5,492
Operating income	4,659	(89)	(99)	4,471
Income tax provision	1,497		(40)	1,457
Net income	\$ 2,512	\$	\$ (58)	\$ 2,454
Net income per share, basic	\$ 0.33	\$	\$ (0.01)	\$ 0.32
Net income per share, diluted	\$ 0.33	\$	\$ (0.01)	\$ 0.32

Six Months Ended June 30, 2005

	Reported	Reclassifications	Restatement Adjustments	Restated
Operating revenues	\$ 69,864	\$	\$ (12)	\$ 69,852
Cost of goods and services	11,152	17,882	179	29,213
Network operating costs	19,931	(19,931)		
Selling, general and administrative	18,591	2,158		20,749
Depreciation and amortization	10,914			10,914
Operating income	9,276	(109)	(191)	8,976
Income tax provision	2,889		(78)	2,811
Net income	\$ 4,907	\$	\$ (112)	\$ 4,795
Net income per share, basic	\$ 0.64	\$	\$ (0.01)	\$ 0.63
Net income per share, diluted	\$ 0.64	\$	\$ (0.02)	\$ 0.62

3. Certain amounts reported in the prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders' equity, including the following reclassifications and changes in presentation:

The Company combined the income statement line items network operating costs and cost of goods and services. Cost of goods and services consists primarily of the cost of equipment sold, cost of long distance service resold, cost of video, phone and network services, cost of PCS travel and roaming services and cost of operating and maintaining the various networks. To conform to the current period presentation, for the three and six months ended June 30, 2005, the Company reclassified \$10.2 million and \$19.9 million in network operating costs to cost of goods and services.

During the current period, the Company recorded commission expense to selling, general and administrative expense. During 2005, a portion of these costs were recorded to cost of goods and services. To conform to the current period presentation, for the three and six months ended June 30, 2005, the Company reclassified \$1.1 million and \$2.2 million in commission expense to selling, general and administrative expense.

During 2005, the Company recorded gains and losses on the sale of equipment in the income statement line item Cost of goods and services. To conform to the current period presentation, for the three and six months ended June 30, 2005, the Company reclassified \$89 thousand and \$109 thousand from Non-operating income, net to Cost of goods and services.

The Company has separately disclosed the operating portion of the cash flows attributable to its discontinued operations, which for the six months ended June 30, 2005, was not separately disclosed. During the six months ended June 30, 2005, there were no cash flows from investing or financing activities for discontinued operations. In 2006, there were no cash flows attributable to discontinued operations.

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4. Operating revenues and income from operations for any interim period are not necessarily indicative of results that may be expected for the entire year.

5. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123, Share-Based Payment (Revised 2004) (SFAS 123(R)) using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, for equity classified awards, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized over the requisite service period. For those tandem awards of stock options and stock appreciation rights (SARs) which are liability classified awards, fair value is calculated at the grant date and each subsequent reporting date during both the requisite service period and each subsequent period until settlement.

In periods prior to the adoption of SFAS 123(R), the Company accounted for its stock options granted under the Company Stock Incentive Plan (the Plan) by applying the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25 issued in March 2000. Under this method, compensation expense was recorded on the date of the grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, Accounting for Stock-Based Compensation established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. The Company provided the disclosures required under SFAS No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. No compensation expense was recognized under the Plan for years prior to 2004 since all such options were granted with an exercise price equal to the market price at the date of the grant. During the year ended December 31, 2004, the Company issued SARs which were accounted for as stock appreciation rights and, therefore, the Company recorded a liability for the related expense since it was assumed the awards will be settled in cash. On March 18, 2005, the Company issued SARs with a net-share settlement feature. The cash-settlement feature was eliminated for the 2005 option grant. However, due to the net-share settlement feature, the Company accounted for these awards as stock appreciation rights and recognized compensation expense over the vesting period to the extent the current stock price exceeded the exercise price of the options. For both the 2004 and 2005 SARs grants, the adoption of SFAS 123(R) resulted in a change in the measurement of compensation expense from an intrinsic method to a fair value method.

The following table presents the effect on net income and net income per share as if the Company had applied the fair value recognition provisions of SFAS 123(R) to options granted under the Plan prior to the adoption. Disclosures for the three and six months ended June 30, 2006 are not presented because stock-based payments were accounted for under SFAS 123(R) s fair-value method during this period.

(in thousands, except per share amounts)	Three Months Ended June 30, 2005 (Restated)	Six Months Ended June 30, 2005 (Restated)
Net Income		
As reported	\$ 2,454	\$ 4,795
Add: Recorded stock-based compensation expense included in reported net income, net of related income tax effects		
Deduct: Pro forma compensation expense, net of related income tax effects	18	41
Pro forma	\$ 2,436	\$ 4,754
Earnings per share, basic and diluted		
As reported, basic	\$ 0.32	\$ 0.63
As reported, diluted	0.32	0.62
Pro forma, basic	0.32	0.62
Pro forma, diluted	\$ 0.32	\$ 0.62

The Company maintains a shareholder-approved Company Stock Incentive Plan approved in 1996 (the 1996 Plan), providing for the grant of incentive compensation to essentially all employees in the form of stock options. The 1996 Plan authorized grants of options to purchase up to 480,000 shares of common stock over a ten-year period beginning

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in 1996. The term of the 1996 Plan expired in February of 2006. During 2005, a new Company Stock Incentive Plan was approved, the 2005 Plan, under which 480,000 shares may be issued over a ten-year period beginning in 2005. The option price for all grants has been at the current market price at the time of the grant. Grants have generally provided that one-half of the options vest and become exercisable on each of the first and second anniversaries of the grant date, with the options expiring on the fifth anniversary of the grant date. In the year ended December 31, 2003, the Company also issued a grant pursuant to which the options are vested over a five-year period beginning on the third anniversary of the grant date. The participant may exercise 20% of the total grant after each anniversary date from the third through the seventh year, with the options expiring on the tenth anniversary of the grant date. In the years ended December 31, 2005 and 2004, the Company also made grants pursuant to which the options are vested over a four-year period beginning on the third anniversary of the grant date. The participants may exercise 25% of the total grant after each anniversary date from the third through the sixth year, with the options expiring on the seventh anniversary of the grant date. The Company did not grant any options during the first six months of 2006.

The impact of initially applying SFAS 123(R) is recognized as of the effective date using the modified prospective method. Under the modified prospective method the Company recognized stock-based compensation expense from January 1, 2006, as if the fair value based accounting method had been used to account for all outstanding unvested employee awards granted in prior years. Results of prior periods have not been restated. The effect of recording stock-based compensation for the three and six month period ended June 30, 2006 was as follows:

(in thousands, except per share amounts)	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Stock-based compensation expense	\$ 30	\$ 346	\$ 599	\$ 504
Cumulative effect of change in accounting		125		
Total stock compensation expense	30	471	599	504
Tax effect on stock-based compensation expense	12	183	234	197
Net effect on net income	\$ 18	\$ 288	\$ 365	\$ 307
Effect on net income per share:				
Basic and diluted	\$	\$ (0.04)	\$ (0.05)	\$ (0.04)

For the three and six month period ended June 30, 2005, stock-based compensation expense was recorded under APB Opinion No. 25.

As required by SFAS 123(R), management has made an estimate of expected forfeitures and is recognizing compensation costs only for those awards expected to vest. For outstanding options previously classified as a liability and which continue to be classified as a liability under SFAS 123(R), the Company recognized the effect of initially re-measuring the liability from its intrinsic value to its fair value as a cumulative effect of a change in accounting principle. The cumulative effect of initially adopting SFAS 123(R) was \$77 thousand, net of the tax effect. During the three and six months ended June 30, 2006, the total cash received as a result of employee stock option exercises was \$0.3 million and \$0.6 million, respectively, and the actual tax benefit realized for the tax deductions was \$0.1 million and \$0.2 million, respectively.

The fair value of each option grant is estimated using a Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Expected term (in years)	2.46	3.50	2.68	3.50
Volatility	40.17%	45.73%	41.74%	45.73%
Risk free rate	5.14%	4.30%	4.98%	4.30%
Expected dividends	0.98%	1.42%	1.00%	1.42%

For the three and six months ended June 30, 2006, the assumptions were used to calculate the fair value of the options classified as a liability. The fair value of options classified as a liability is calculated at the grant date and each subsequent reporting date until the options are settled.

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Volatility is based on the historical volatility of the price of the Company's stock over the expected term of the options. The expected term represents the period of time that the options granted are expected to be outstanding. The risk free rate is based on the U.S. Treasury yield curve, in effect at the date the fair value of the options is calculated, with an equivalent term.

The following table summarizes option activity for the first six months of 2006:

	Options	Weighted Average Grant Price Per Option
Outstanding December 31, 2005	240,863	\$24.73
Granted		
Cancelled	(3,302)	28.96
Exercised	(16,394)	18.47
Outstanding March 31, 2006	221,167	25.13
Granted		
Cancelled	(20,560)	24.88
Exercised	(13,717)	23.85
Outstanding June 30, 2006	186,890	25.26

The following table summarizes information about stock options outstanding at June 30, 2006:

	Exercise Prices	Options Outstanding	Option Life Remaining	Options Exercisable
2002	\$ 17.59	18,071	.75 years	18,071
2003	\$17.98-22.01	45,840	1.75 to 7 years	29,840
2004	\$23.00-26.46	56,228	2.75 to 5.50 years	41,228
2005	\$30.29-40.53	66,751	3.75 to 6.25 years	23,376

There were options for 112,515 shares exercisable at June 30, 2006 at a weighted average exercise price of \$22.77 per share, an aggregate intrinsic value of \$2.4 million and a weighted-average remaining contractual life of 2.4 years. There were options for 186,890 shares outstanding at June 30, 2006 at a weighted average exercise price of \$25.26 per share, an aggregate intrinsic value of \$3.5 million and a weighted-average remaining contractual life of 3.5 years. The aggregate intrinsic value represents the total pretax intrinsic value, based on the Company's average closing stock price of \$43.83 during the six months ended June 30, 2006.

The total fair value of options vested during the three and six months ended June 30, 2006 was \$46 thousand and \$1.0 million, respectively. The total intrinsic value of options exercised during the three and six months ended June 30, 2006 was \$0.3 million and \$0.7 million, respectively. The options-based liabilities paid during the three and six months ended June 30, 2006 was \$36 thousand and \$43 thousand, respectively.

As of June 30, 2006, the total compensation cost related to nonvested options not yet recognized is \$0.4 million which will be recognized over a weighted-average period of 2.6 years.

6. Basic net income per share was computed on the weighted average number of shares outstanding. Diluted net income per share was computed under the treasury stock method, assuming the conversion as of the beginning of the period, for all dilutive stock options. The adjustments to net income reflect the impact of compensation related to stock appreciation rights recorded in the respective periods, and the impact of the pro forma compensation expense, both net of the income tax effect.

7. SFAS Statement No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision makers. The Company has six reportable segments, which the Company operates and manages as strategic

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business units organized geographically and by lines of business: (1) PCS, (2) Telephone, (3) Converged Services (NTC), (4) Mobile, (5) Holding and (6) Other.

Prior to the September 30, 2005 quarterly report, the Company reported 11 segments, however, beginning with the September 30, 2005 quarterly report, the Company reported six segments with the following segments combined into Other : ShenTel Service Company, Shenandoah Cable Television Company, Shenandoah Network Company, Shenandoah Long Distance Company, ShenTel Communications Company, Shentel Wireless Company and Converged Services of West Virginia. During the third quarter of 2005, Shenandoah Valley Leasing Company changed its name to Shentel Wireless Company to reflect the activities associated with the Company's Wireless Broadband Group. The Company believes that the new presentation will allow for a more meaningful discussion of the segment results.

The results for the three and six months ended June 30, 2005 have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 for additional discussion.

The PCS segment, as a Sprint PCS Affiliate of Sprint Nextel, provides digital wireless service to a portion of a four-state area covering the region from Harrisburg, York and Altoona, Pennsylvania, to Harrisonburg, Virginia.

The Telephone segment provides both regulated and unregulated telephone services and leases fiber optic facilities primarily throughout the northern Shenandoah Valley.

The Converged Services segment provides local and long distance voice, video and internet services on an exclusive and non-exclusive basis to MDU communities (primarily off-campus college student housing) throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi. Converged Services includes NTC, purchased by the Company on November 30, 2004.

The Mobile segment provides tower rental space to affiliates and non-affiliates in the Company's PCS markets and paging services throughout the northern Shenandoah Valley.

Selected financial data for each segment is as follows:

Three Months Ended June 30, 2006

(in thousands)

	PCS	Telephone	Converged Services (NTC)	Mobile	Holding	Other	Eliminations	Consolidated Totals
External revenues								
Service revenues	\$ 18,262	\$ 1,641	\$ 2,531	\$	\$	\$ 2,837	\$	\$ 25,271
Access charges		2,786						2,786
Travel/roaming revenue	8,054							8,054
Facilities and tower lease		1,018		874		463		2,355
Equipment	1,053	9				213		1,275
Other	474	780	124	33		274		1,685
Total external revenues	27,843	6,234	2,655	907		3,787		41,426
Internal revenues		1,397		417		633	(2,447)	
Total operating revenues	27,843	7,631	2,655	1,324		4,420	(2,447)	41,426
Operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	12,622	1,796	2,140	390	4	2,759	(2,148)	17,563
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	7,605	1,288	1,342	162	506	1,373	(299)	11,977

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Depreciation and amortization	3,557	1,219	1,598	210	17	513		7,114
Total operating expenses	23,784	4,303	5,080	762	527	4,645	(2,447)	36,654
Operating income (loss)	4,059	3,328	(2,425)	562	(527)	(225)		4,772
Non-operating income (expense)	106	261	3		1,142	11	(1,003)	520
Interest expense	(447)	(63)	(260)	(91)	(599)	(153)	1,003	(610)
Income taxes	(1,520)	(1,339)	1,027	(188)	(20)	141		(1,899)
Net income (loss)	\$ 2,198	\$ 2,187	\$ (1,655)	\$ 283	\$ (4)	\$ (226)	\$	\$ 2,783

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Three Months Ended June 30, 2005 (Restated)

(in thousands)

	PCS	Telephone	Converged Services (NTC)	Mobile	Holding	Other	Eliminations	Consolidated Totals
External revenues								
Service revenues	\$ 15,265	\$ 1,627	\$ 2,252	\$	\$	\$ 2,676	\$	\$ 21,820
Access charges		2,661						2,661
Travel/roaming revenue	6,642							6,642
Facilities and tower lease		1,003		784		324		2,111
Equipment	780	5				109		894
Other	311	679	15	44		280		1,329
Total external revenues	22,998	5,975	2,267	828		3,389		35,457
Internal revenues		1,003		344		596	(1,943)	
Total operating revenues	22,998	6,978	2,267	1,172		3,985	(1,943)	35,457
Operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	10,946	1,690	1,522	328	6	2,093	(1,630)	14,955
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	6,837	1,326	1,084	149	388	1,068	(313)	10,539
Depreciation and amortization	3,069	1,101	679	175	15	453		5,492
Total operating expenses	20,852	4,117	3,285	652	409	3,614	(1,943)	30,986
Operating income (loss)	2,146	2,861	(1,018)	520	(409)	371		4,471
Non-operating income (expense)								
Interest expense	(420)	(72)	(214)	(64)	(697)	(127)	824	(770)
Income taxes	(642)	(1,051)	459	(191)	63	(95)		(1,457)
Net income (loss)	\$ 1,084	\$ 1,791	\$ (767)	\$ 298	\$ (108)	\$ 156	\$	\$ 2,454

Six Months Ended June 30, 2006

(in thousands)

	PCS	Telephone	Converged Services (NTC)	Mobile	Holding	Other	Eliminations	Consolidated Totals
External revenues								
Service revenues	\$ 36,125	\$ 3,273	\$ 5,207	\$	\$	\$ 5,600	\$	\$ 50,205
Access charges		5,704						5,704
Travel/roaming revenue	15,114							15,114
Facilities and tower lease		1,979		1,732		975		4,686
Equipment	2,035	14				311		2,360
Other	734	1,535	242	68		578		3,157

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Total external revenues	54,008	12,505	5,449	1,800		7,464		81,226
Internal revenues		2,781		808		1,292	(4,881)	
Total operating revenues	54,008	15,286	5,449	2,608		8,756	(4,881)	81,226
Operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	24,731	3,612	4,239	805	4	5,344	(4,288)	34,447
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	15,589	2,416	2,610	323	1,166	2,693	(593)	24,204
Depreciation and amortization	7,053	2,425	2,648	407	34	1,086		13,653
Total operating expenses	47,373	8,453	9,497	1,535	1,204	9,123	(4,881)	72,304
Operating income (loss)	6,635	6,833	(4,048)	1,073	(1,204)	(367)		8,922
Non-operating income (expense)								
Interest expense	(886)	(128)	(486)	(160)	(1,217)	(280)	1,899	(1,258)
Income taxes	(2,419)	(6,689)	1,713	(370)	121	223		(7,421)
Cumulative effect of change in accounting, net of tax	(11)	(27)	(21)	(1)	(2)	(15)		(77)
Net income (loss)	\$ 3,453	\$ 10,809	\$ (2,827)	\$ 553	\$ (242)	\$ (420)	\$	\$ 11,326

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Six Months Ended June 30, 2005 (Restated)

(in thousands)

	PCS	Telephone	Converged Services (NTC)	Mobile	Holding	Other	Eliminations	Consolidated Totals
External revenues								
Service revenues	\$ 29,845	\$ 3,232	\$ 4,593	\$	\$	\$ 5,279	\$	\$ 42,949
Access charges		5,367						5,367
Travel/roaming revenue	12,713							12,713
Facilities and tower lease		1,977		1,545		624		4,146
Equipment	1,620	6				257		1,883
Other	604	1,417	33	73		667		2,794
Total external revenues	44,782	11,999	4,626	1,618		6,827		69,852
Internal revenues		1,919		680		1,177	(3,776)	
Total operating revenues	44,782	13,918	4,626	2,298		8,004	(3,776)	69,852
Operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	21,316	3,176	2,970	628	13	4,264	(3,154)	29,213
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	13,472	2,702	2,075	311	641	2,170	(622)	20,749
Depreciation and amortization	6,060	2,204	1,357	351	31	911		10,914
Total operating expenses	40,848	8,082	6,402	1,290	685	7,345	(3,776)	60,876
Operating income (loss)	3,934	5,836	(1,776)	1,008	(685)	659		8,976
Non-operating income (expense)								
Interest expense	(826)	(147)	(460)	(123)	(1,464)	(245)	1,641	(1,624)
Income taxes	(1,151)	(2,134)	834	(371)	174	(163)		(2,811)
Net income (loss)	\$ 1,957	\$ 3,644	\$ (1,396)	\$ 580	\$ (259)	\$ 269	\$	\$ 4,795

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The Company's assets by segment are as follows:

In thousands (unaudited)	June 30, 2006	December 31, 2005	June 30, 2005
			(Restated)
PCS	\$ 84,484	\$ 81,796	\$ 68,149
Telephone	70,807	59,873	59,523
Converged Services	22,809	27,107	21,665
Mobile	15,174	20,039	18,127
Holding	145,419	143,308	143,874
Other	22,585	23,154	19,321
Combined totals	361,278	355,277	330,659
Inter-segment eliminations	(149,585)	(150,356)	(129,532)
Consolidated totals	\$ 211,693	\$ 204,921	\$ 201,127

8. Comprehensive income includes net income along with net unrealized gains and losses on the Company's available-for-sale investments, net of the related income tax effect. The following is a summary of comprehensive income for the periods indicated:

In thousands (unaudited)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
				(Restated)
Net income	\$ 2,783	\$ 2,454	\$ 11,326	\$ 4,795
Net unrealized loss		(5)		(24)
Comprehensive income	\$ 2,783	\$ 2,449	\$ 11,326	\$ 4,771

9. The following table presents pension cost for the periods presented.

In thousands (unaudited)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net periodic benefit cost recognized:				
Service cost	\$ 311	\$ 223	\$ 622	\$ 446
Interest cost	251	211	502	422
Expected return	(234)	(198)	(468)	(396)
Amortization of unrecognized loss	42	23	84	46
Amortization of unrecognized prior service cost	20	17	40	34
Total	\$ 390	\$ 276	\$ 780	\$ 552

10. On August 4, 2005, the board of directors of the Rural Telephone Bank (the "RTB") adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

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11. On August 12, 2005, Sprint Corporation and Nextel Communications, Inc. merged to form Sprint Nextel Corporation. Nextel and its affiliate Nextel Partners, Inc. are providers of digital wireless communications services in the Company's PCS service area. Certain transactions resulting from, or potential effects of, the Sprint Nextel merger discussed below could adversely affect our PCS business as well as our overall results of operations.

The Company's PCS subsidiary is one of a number of companies we refer to as the Sprint PCS Affiliates, which had entered into substantially similar management and affiliation agreements with Sprint Communications Company L.P. The agreements, including the agreement with Shentel, were with several Sprint entities. In connection with the Sprint Nextel merger, a number of the Sprint PCS Affiliates filed suit against Sprint Nextel alleging that the merger would result in a breach of the exclusivity provisions of their agreements with Sprint Nextel. A number of these legal proceedings are pending. In addition, since the Sprint Nextel merger was announced, Sprint Nextel has acquired several of the Sprint PCS Affiliates.

Prior to the Sprint Nextel merger, the Company and Sprint Nextel entered into a forbearance agreement setting forth Sprint Nextel's agreement to observe specified limitations in operating Nextel's wireless business in the Company's PCS service area. The agreement also set forth the Company's agreement not to initiate litigation or seek certain injunctive or equitable relief against Sprint Nextel under certain circumstances, in each case during the period in which the agreement remains in effect. The agreement provided that the statute of limitations on any claims that Shentel might have against Sprint Nextel would be tolled while the agreement remained in effect. Nextel Partners was added to a July 19, 2006 amendment to the forbearance agreement between the Company and Sprint Nextel. The forbearance agreement automatically expired on August 4, 2006 in accordance with its terms upon the Court of Chancery of the State of Delaware's issuance of a decision with respect to the pending litigation by some Sprint PCS Affiliates against Sprint Nextel. The Company is reviewing the court's decision and considering the implications, if any, for the Company.

The Company believes that a significant portion of its PCS service area overlaps the service area operated by Nextel Partners under the Nextel brand. On June 26, 2006, Sprint Nextel acquired Nextel Partners. As long as Nextel Partners continues to be operated by Sprint Nextel as a separate business using the Nextel platform, the Company's ability to fully realize any of the benefits from the merger of Sprint and Nextel may be limited. Further, the continued operation by Sprint Nextel of Nextel Partners as a competing network could have a negative impact on the Company's results of operations.

The Company has had discussions with Sprint Nextel regarding the continuation of their long-term relationship, the impact of the Sprint Nextel merger, and potential changes to the management agreement necessary to reflect the merger of Sprint and Nextel Communications and the acquisition of Nextel Partners by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require the Company to meet additional program requirements, which the Company anticipates would significantly increase capital expenditures and operating expenses. To date, the Company has been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, the Company is currently considering other alternatives in its ongoing discussions with Sprint Nextel, including the possible sale of its PCS business to Sprint Nextel. The Company is unable to predict whether or on what terms it would be able to implement a sale of its PCS business, or the ultimate resolution of its discussions with Sprint Nextel concerning its relationship with Sprint Nextel, or the impact of any such sale or other action on its financial condition or future operating results or prospects.

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

This management's discussion and analysis includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this report, the words anticipate, believe, estimate, expect, intend, plan and similar expressions as they relate to Shenandoah Telecommunications Company or its management are intended to identify these forward-looking statements. All statements regarding Shenandoah Telecommunications Company's expected future financial position and operating results, business strategy, financing plans, forecasted trends relating to the markets in which Shenandoah Telecommunications Company operates and similar matters are forward-looking statements. We cannot assure you that the Company's expectations expressed or implied in these forward-looking statements will turn out to be correct. The Company's actual results could be materially different from its expectations because of various factors, including those discussed below and elsewhere in this quarterly report and under the caption Risk Factors in the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2005. The following management's discussion and analysis should be read in conjunction with the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2005, including the financial statements and related notes included therein.

Unless indicated otherwise, dollar amounts fifty thousand and over have been rounded to the nearest hundred thousand dollars and dollar amounts of less than fifty thousand have been rounded to the nearest thousand dollars.

General

Overview. Shenandoah Telecommunications Company is a diversified telecommunications company providing both regulated and unregulated telecommunications services through its wholly owned subsidiaries. These subsidiaries provide local exchange telephone services and wireless personal communications services (as a Sprint PCS affiliate of Sprint Nextel), as well as cable television, video, Internet and data services, long distance, sale of telecommunications equipment, fiber optics facilities, paging and leased tower facilities. The Company has the following six reporting segments, which it operates and manages as strategic business units organized geographically and by lines of business:

wireless personal communications services, or PCS, as a Sprint PCS Affiliate, through Shenandoah Personal Communications Company;

telephone, which involves the provision of regulated and non-regulated telephone services, through Shenandoah Telephone Company;

converged services, which involves the provision of data, video, voice and long-distance services, through Shentel Converged Services, Inc. and NTC Communications, LLC;

mobile, which involves the provision of tower leases and paging services, through Shenandoah Mobile Company;

holding, which involves the provision of investments and management services to its subsidiaries, through Shenandoah Telecommunications Company; and

other, which involves the provision of Internet, cable television, network facility leasing, long-distance, CLEC, and wireless broadband services, through ShenTel Service Company, Shenandoah Cable Television Company, Shenandoah Network Company, Shenandoah Long Distance Company, ShenTel Communications Company, Converged Services of West Virginia and Shentel Wireless Company.

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During the third quarter of 2005, Shenandoah Valley Leasing Company changed its name to Shentel Wireless Company to record the activities associated with the Company's Wireless Broadband Group.

The Company is the exclusive provider of wireless mobility communications network products and services on the 1900 MHz band under the Sprint brand from Harrisonburg, Virginia to Harrisburg, York and Altoona, Pennsylvania. The Company refers to the Chambersburg, Pennsylvania; Hagerstown, Maryland; Martinsburg, West Virginia; and Harrisonburg and Winchester, Virginia markets as its Quad States markets. The Company refers to the Altoona, Harrisburg, and York, Pennsylvania markets as its Central Penn markets. The Company's primary service area for the telephone, cable television and long-distance business is Shenandoah County, Virginia. The county is a rural area in northwestern Virginia, with a population of approximately 38,000 inhabitants, which has increased by approximately 3,000 since 2000. While a number of new housing developments are being planned for Shenandoah County, the Company believes that the potential for significant numbers of additional wireline customers in the Shenandoah County operating area is limited. In 2002, the Company established a competitive local exchange carrier in Virginia to provide services on a limited basis.

As a result of the November 30, 2004 acquisition of the 83.9% of NTC Communications, L.L.C. (NTC) that the Company did not already own, the Company, through its subsidiary Shentel Converged Services, provides local and long distance voice, video and Internet services on an exclusive and non-exclusive basis to MDU communities, consisting primarily of off-campus college student housing throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi.

The Company sells and leases equipment, mainly related to the services it provides. The Company participates in emerging services and technologies by investment in technology venture funds and direct investment in non-affiliated companies.

On May 10, 2006, Shenandoah Telecommunications Company through its subsidiary, Shenandoah Mobile Company, filed an application to participate in FCC Spectrum Auction #66 for Advanced Wireless Services (AWS). The AWS spectrum, located in the 1710-1755 and 2110-2155 MHz bands in the mid-atlantic and southeastern United States, is designated for fixed and mobile terrestrial wireless applications using bandwidth that is sufficient for the provision of a variety of applications including those using voice and data content.

On July 7, 2006, the application was approved and on July 17, 2006, a refundable upfront payment of \$4.7 million was submitted on behalf of Shenandoah Mobile Company. The auction is scheduled to begin on August 9, 2006.

Restatement of Financial Results: The Company's financial statements as of and for the years ended December 31, 2004 and 2003, including the beginning retained earnings for the year ended December 31, 2003, all quarters in 2004 and the first three quarters of the year ended December 31, 2005, were restated to correct errors relating to the Company's accounting for operating leases. While management believes that the impact of this error is not material to any previously issued financial statements, it determined that the cumulative adjustment required to correct this error was too large to record in 2005.

The Company's method of accounting for operating leases did not comply with the requirements of SFAS No. 13, Accounting for Leases and FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases. Historically, the Company has not assumed the exercise of available renewal options in accounting for operating leases. The Company has operating leases, primarily for cell sites owned by third parties, land leases for towers owned by the Company and leases with third parties for space on the Company's towers that have escalating rentals during the initial lease term and during succeeding optional renewal periods. In light of the Company's investment in each site, including acquisition costs and leasehold improvements, the Company determined that the exercise of certain renewal options was reasonably assured at the inception of the leases. Accordingly, the Company has corrected its accounting to recognize rent expense on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Where the Company is the lessor, it will recognize revenue on a straight-line basis over the current term of the lease.

See Note 2 to the Company's unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information.

The following management's discussion and analysis, for the three and six months ended June 30, 2005, reflects the effects of the restatements.

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Additional Information About the Company's Business

The following table shows selected operating statistics of the Company for the most recent five quarters.

	June 30, 2006	Mar. 31, 2006	Dec. 31, 2005	Sept. 30, 2005	June 30, 2005
Telephone Access Lines	24,935	24,988	24,740	24,811	24,877
Cable Television Subscribers	8,555	8,629	8,684	8,677	8,627
Dial-up Internet Subscribers	11,512	12,069	12,514	13,273	14,052
DSL Subscribers	5,373	5,089	4,748	4,062	3,427
Retail PCS Subscribers	134,559	129,124	122,975	116,460	112,090
Wholesale PCS Users (1)	40,013	39,798	38,726	33,848	32,733
Long Distance Subscribers	10,458	10,431	10,418	10,318	10,258
Fiber Route Miles	618	616	616	579	576
Total Fiber Miles	33,444	33,367	33,201	29,734	29,566
Long Distance Calls (000) (2)	7,003	6,745	6,686	6,808	6,808
Total Switched Access Minutes (000)	76,019	74,361	75,209	74,515	70,419
Originating Switched Access Minutes (000)	22,484	22,541	21,807	20,627	19,570
Employees (full time equivalents) (3)	382	391	387	375	408
CDMA Base Stations (sites)	328	325	311	301	288
Towers (100 foot and over)	97	94	85	82	81
Towers (under 100 foot)	13	13	13	13	11
PCS Market POPS (000) (4)	2,242	2,236	2,236	2,199	2,199
PCS Covered POPS (000) (4)	1,728	1,704	1,704	1,658	1,649
PCS Ave. Monthly Retail Churn % (5)	1.9%	1.9%	1.9%	2.1%	1.9%
Converged Services (NTC) Properties Served (6)	106	108	109	108	111
Converged Services (NTC) Bulk Accounts (7)	41	40	41	41	36
Converged Services (NTC) Retail Accounts (8)	8,477	9,937	10,009	10,945	9,708
Converged Services (NTC) Video Service Users (9)	7,374	8,415	8,461	8,424	6,621
Converged Services (NTC) Telephone Service Users (9)	8,797	9,766	9,914	9,843	9,074
Converged Services (NTC) Network/Internet Users (9)	18,719	22,783	22,901	22,433	18,029

- (1) Wholesale PCS Users are private label subscribers with numbers homed in the Company's wireless network service area.
- (2) Originated by customers of the Company's Telephone subsidiary.
- (3) The June 30, 2005 employee count includes 44 interns.
- (4) POPS refers to the estimated population of a given geographic area and is based on information purchased by Sprint Nextel from Geographic Information Services. Market POPS are those within a market area which the Company is authorized to serve under its Sprint PCS affiliate agreements, and Covered POPS are those covered by the network's service area.
- (5) PCS Ave. Monthly Churn is the average of the three monthly subscriber turnover, or churn calculations for the period.
- (6) Indicates MDU complexes where NTC provides service.
- (7) Service is provided under a single contract with the property owner who typically provides service to tenants as part of their lease.
- (8) Service is provided under contract with individual subscribers.
- (9) Bulk and retail subscribers combined by service type. The variations in users between quarters reflect the impact of the cycles of the academic year.

Significant Transactions

On August 4, 2005, the board of directors of the Rural Telephone Bank (the RTB) adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

Results of Continuing Operations**Three and Six Months Ended June 30, 2006 Compared with the Three and Six Months Ended June 30, 2005****Consolidated Results**

The results for the three and six months ended June 30, 2005, have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information.

The Company's consolidated results for the second quarter and the first six months of 2006 and 2005 are summarized as follows:

(in thousands)	Three Months Ended		Change		Six Months Ended		Change	
	June 30, 2006	June 30, 2005	\$	%	June 30, 2006	June 30, 2005	\$	%
		(Restated)				(Restated)		
Operating revenues	\$ 41,426	\$ 35,457	\$ 5,969	16.8	\$ 81,226	\$ 69,852	\$ 11,374	16.3
Operating expenses	36,654	30,986	5,668	18.3	72,304	60,876	11,428	18.8
Operating income	4,772	4,471	301	6.7	8,922	8,976	(54)	(0.6)
Other income (expense)	(90)	(560)	470	83.9	9,902	(1,370)	11,272	822.8
Net income	\$ 2,783	\$ 2,454	\$ 329	13.4	\$ 11,326	\$ 4,795	\$ 6,531	136.2

Operating revenues

For the three and six months ended June 30, 2006, operating revenue increased \$6.0 million, or 16.8%, and \$11.4 million, or 16.3%, respectively, compared to the same periods in 2005. The increase was primarily due to the growth in the Company's PCS segment. For the three and six months ended June 30, 2006, PCS operating revenues increased \$4.8 million, or 21.1%, and \$9.2 million, or 20.6%, respectively, Telephone operating revenues increased \$0.7 million, or 9.4%, and \$1.4 million, or 9.8%, respectively, and Converged Services operating revenues increased \$0.4 million, or 17.1%, and \$0.8 million, or 17.8%, respectively.

Operating expenses

For the three and six months ended June 30, 2006, operating expenses increased \$5.7 million, or 18.3%, and \$11.4 million, or 18.8%, respectively, compared to the same periods in 2005. The increase was primarily due to the increases in the Company's PCS and Converged Services segments. For the three and six months ended June 30, 2006, PCS operating expenses increased \$2.9 million, or 14.1%, and \$6.5 million, or 16.0%, respectively, and Converged Services operating expenses increased \$1.8 million, or 54.6%, and \$3.1 million, or 48.3%, respectively.

Other income (expense)

For the three and six months ended June 30, 2006, other income increased \$0.5 million, or 83.9%, and \$11.3 million, or 822.8%, respectively. The increase was primarily due to the Company recognizing a first quarter 2006 gain of approximately \$10.5 million related to the dissolution of the RTB, and the redemption of the stock.

Net Income

For the three and six months ended June 30, 2006, net income increased \$0.3 million, or 13.4%, and \$6.5 million, or 136.2%, respectively, primarily due to the Company recognizing a first quarter 2006 gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB, and the redemption of the stock.

Segment Results

The restatement discussed in Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report, is reflected in those segments affected by the restatement, which are the PCS segment and the Mobile segment. The other segments, Telephone, Converged Services, Holding and other were not affected by the restatement.

PCS

(in thousands)	Three Months Ended				Six Months Ended			
	June 30,		Change		June 30,		Change	
	2006	2005	\$	%	2006	2005	\$	%
	(Restated)				(Restated)			
Segment operating revenues								
Wireless service revenue	\$ 18,262	\$ 15,265	\$ 2,997	19.6	\$ 36,125	\$ 29,845	\$ 6,280	21.0
Travel and roaming revenue	8,054	6,642	1,412	21.3	15,114	12,713	2,401	18.9
Equipment revenue	1,053	780	273	35.0	2,035	1,620	415	25.6
Other revenue	474	311	163	52.4	734	604	130	21.5
Total segment operating revenues	27,843	22,998	4,845	21.1	54,008	44,782	9,226	20.6
Segment operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	12,622	10,946	1,676	15.3	24,731	21,316	3,415	16.0
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	7,605	6,837	768	11.2	15,589	13,472	2,117	15.7
Depreciation and amortization	3,557	3,069	488	15.9	7,053	6,060	993	16.4
Total segment operating expenses	23,784	20,852	2,932	14.1	47,373	40,848	6,525	16.0
Segment operating income	\$ 4,059	\$ 2,146	\$ 1,913	89.1	\$ 6,635	\$ 3,934	\$ 2,701	68.7

The results for the three and six months ended June 30, 2005 have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information. The effect of these restatements on the PCS segment's operating income for the three and six months ended June 30, 2005, was to increase the cost of goods and services and decrease segment operating income by \$48 thousand and \$95 thousand, respectively.

Shenandoah PCS Company, as a Sprint PCS Affiliate of Sprint Nextel, provides digital wireless service to a portion of a four-state area covering the region from Harrisburg, York and Altoona, Pennsylvania, to Harrisonburg, Virginia.

The Company receives revenues from Sprint Nextel for subscribers that obtain service in the Company's network coverage area and other Sprint Nextel subscribers that use the Company's network when they use PCS service within the Company's service area. The Company relies on Sprint Nextel to provide timely, accurate and complete information for the Company to record the appropriate revenue and expenses for each financial period.

The Company had 328 PCS base stations in service at June 30, 2006, compared to 288 base stations in service at June 30, 2005. The increase in base stations was the result of supplementing network capacity and further extending coverage along more heavily traveled secondary roads in the Company's market areas.

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Through Sprint Nextel, the Company receives revenue from wholesale resellers of wireless PCS service. These resellers pay a flat rate per minute of use for all traffic their subscribers generate on the Company's network. The Company's cost to handle this traffic is the incremental cost to provide the necessary network capacity.

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For the three and six months ended June 30, 2006, the Company's net travel and roaming revenues, including the long distance and 3G data portions of that traffic, increased to a \$3.2 million and \$6.3 million, respectively, net contribution to operating income, compared to a \$2.9 million and \$5.6 million, respectively, net contribution to operating income in the comparable periods of 2005. The Company's travel receivable minutes for the three and six months ended June 30, 2006 increased 12.5% to 93.7 million and 13.4% to 177.6 million, respectively, and the travel payable minutes increased by 10.7% to 66.9 million and 13.0% to 129.0 million, respectively, compared to the same periods in 2005. The increases in travel minutes receivable and payable are primarily the result of an increase in usage of the Company's network facilities by subscribers based in other markets and growth in subscribers in the Company's markets using PCS service outside of the Company's service area.

For the three and six months ended June 30, 2006, on a per-subscriber basis, the Company's average of travel payable minutes decreased to 169 minutes per month and 167 minutes per month, respectively, which represented a decrease of 15 minutes per month and 5 minutes per month from the same periods in 2005.

The Company's average PCS retail customer turnover, or churn rate, was 1.9% in both the second quarter of 2006 and the second quarter of 2005. For the three and six months ended June 30, 2006, there was an increase in PCS bad debt expense to 3.2% and 3.5%, respectively, of PCS service revenues compared to 3.0% and 3.2%, respectively, in the same periods in 2005. Although management continues to monitor receivables, collection efforts and new subscriber credit ratings, there is no certainty that the bad debt expense will not continue to increase in the future.

Operating revenues

For the three and six months ended June 30, 2006, wireless service revenues from retail customers increased \$3.0 million, or 19.6%, and \$6.3 million, or 21.0%, respectively. As of June 30, 2006, the Company had 134,599 retail PCS subscribers compared to 112,090 subscribers at June 30, 2005. The PCS operation added 5,435 net retail customers in the second quarter of 2006 compared to 5,166 net retail subscribers added in the second quarter of 2005. In addition, net wholesale users increased by 215 during the second quarter of 2006 compared to 1,229 added in the second quarter of 2005.

For the three and six months ended June 30, 2006, PCS travel and roaming revenues increased \$1.4 million, or 21.3%, and \$2.4 million, or 18.9%, respectively. The travel and roaming revenue increase resulted from an increase in travel usage by Sprint Nextel and other Sprint PCS affiliates on the Company's network. For the second quarter of 2006, the travel rate the Company received from Sprint Nextel was \$0.058 per minute, which was the same rate as in the second quarter of 2005. For the three and six months ended June 30, 2006, roaming revenue declined \$40 thousand, or 8.0%, and \$0.1 million, or 13.7%, respectively, due to decreasing roaming rates and a decrease in volume as other carriers continue to expand their networks in the Company's service area.

For the three and six months ended June 30, 2006, PCS equipment revenues increased \$0.3 million, or 35.0%, and \$0.4 million, or 25.6%, respectively. The increase was primarily due to the addition of new PCS subscribers in the second quarter of 2006 and more subscribers upgrading their handsets to access new features provided with the service. The effect of these factors was offset in part by a lower average price received for handset equipment during the second quarter of 2006.

Cost of goods and services

For the three and six months ended June 30, 2006, cost of PCS goods and services increased \$1.7 million, or 15.3%, and \$3.4 million, or 16.0%, respectively. For the three and six months ended June 30, 2006, PCS travel costs increased \$1.1 million, or 27.3%, to \$5.3 million and \$1.9 million, or 24.1%, to \$10.0 million, respectively. The travel costs increased due to an increase in travel minutes used by the Company's subscribers on the Sprint Nextel or Sprint PCS Affiliate networks not operated by the Company.

For the three and six months ended June 30, 2006, cost of goods and services experienced additional increases, for rent expense of \$0.2 million and \$0.4 million, respectively, network costs of \$0.4 million and \$0.6 million, respectively and PCS long distance costs of \$0.1 million and \$0.2 million, respectively.

Selling, general and administrative

For the three and six months ended June 30, 2006, selling, general and administrative costs increased \$0.8 million, or 11.2%, and \$2.1 million, or 15.7%, respectively. The increase was primarily attributable to an increase in the amount

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paid to Sprint Nextel for the administration of the customer base of \$0.4 million and \$0.7 million, respectively, due to an increase in customers, an increase in commissions paid to Radio Shack Corporation of \$0.2 million and \$0.6 million, respectively, an increase of \$0.3 million and \$0.7 million, respectively, for commissions paid to other national and local third-party retailers and an increase in bad debt expense of \$0.1 million and \$0.3 million, respectively. These increases were offset by a decrease in allocated shared services costs of \$0.1 million and \$0.4 million, respectively.

Telephone

(in thousands)	Three Months Ended June 30,				Six Months Ended June 30,				
	2006	2005	Change		2006	2005	Change		
			\$	%			\$	%	
Segment operating revenues									
Service revenue wireline	\$ 1,723	\$ 1,716	\$ 7	0.4	\$ 3,440	\$ 3,411	\$ 29	0.9	
Access revenue	3,223	3,021	202	6.7	6,547	6,021	526	8.7	
Facilities lease revenue	1,775	1,485	290	19.5	3,512	2,918	594	20.4	
Equipment revenue	9	5	4	80.0	14	6	8	133.3	
Other revenue	901	751	150	20.0	1,773	1,562	211	13.5	
Total segment operating revenues	7,631	6,978	653	9.4	15,286	13,918	1,368	9.8	
Segment operating expenses									
Cost of goods and services, exclusive of depreciation and amortization shown separately below	1,796	1,690	106	6.3	3,612	3,176	436	13.7	
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	1,288	1,326	(38)	(2.9)	2,416	2,702	(286)	(10.6)	
Depreciation and amortization	1,219	1,101	118	10.7	2,425	2,204	221	10.0	
Total segment operating expenses	4,303	4,117	186	4.50	8,453	8,082	371	4.6	
Segment operating income	\$ 3,328	\$ 2,861	\$ 467	16.3	\$ 6,833	\$ 5,836	\$ 997	17.1	

Shenandoah Telephone Company provides both regulated and unregulated telephone services and leases fiber optic facilities throughout the northern Shenandoah Valley and northern Virginia. The telephone segment's results were not affected by the restatement discussed in Note 2 to the consolidated financial statements appearing elsewhere in this report.

During the second quarter of 2006, the Company's telephone access line count declined by 53 access lines. Although growth in new housing starts in the Company's local telephone area resulted in a net increase of 195 access lines during the first six months of 2006, the trend over past periods has been a decline in subscribers, principally due to consumer migration to wireless and DSL services from traditional telephone services. The construction of new homes within Shenandoah County appears to have moderated. Based on industry experience, however, the Company anticipates that the long-term trend toward declining telephone subscriber counts may dominate for the foreseeable future.

Operating Revenues

For the three and six months ended June 30, 2006, total switched minutes of use on the local telephone network increased by 8.0% and 8.8%, respectively, compared to 2005. The mix of minutes that terminate to wireless carriers compared to total minutes shifted from 51.1% and 50.1% for the three and six months ended June 30, 2005, respectively, to 51.7% and 50.9% for the three and six months ended June 30, 2006, respectively. The increase in minutes was primarily attributable to the increase in wireless traffic transiting the Company's telephone network.

For the three and six months ended June 30, 2006, access revenues increased \$0.2 million, or 6.7%, and \$0.5 million, or 8.7%, respectively, primarily due to a \$0.2 million and \$0.4 million, respectively, increase in revenue administered by the National Exchange Carrier Association (NECA) and a \$0.1 million and \$0.2 million, respectively, increase in DSL wholesale revenue billed to Shentel Service Company.

For the three and six months ended June 30, 2006, facilities lease revenue increased \$0.3 million, or 19.5%, and \$0.6 million, or 20.4%, respectively, due to additional fiber capacity being leased during the first six months of 2006 compared to the first six months of 2005.

Cost of goods and services

For the three and six months ended June 30, 2006, cost of goods and services increased \$0.1 million, or 6.3%, and \$0.4 million, or 13.7%, respectively, primarily due to increases in network maintenance and repair expenses.

Converged Services

(in thousands)	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2006	2005	\$	%	2006	2005	\$	%
Segment operating revenues								
Service revenue wireline	\$ 2,531	\$ 2,252	\$ 279	12.4	\$ 5,207	\$ 4,593	\$ 614	13.4
Other revenue	124	15	109	726.7	242	33	209	633.3
Total segment operating revenues	2,655	2,267	388	17.1	5,449	4,626	823	17.8
Segment operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	2,140	1,522	618	40.6	4,239	2,970	1,269	42.7
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	1,342	1,084	258	23.8	2,610	2,075	535	25.8
Depreciation and amortization	1,598	679	919	135.3	2,648	1,357	1,291	95.1
Total segment operating expenses	5,080	3,285	1,795	54.6	9,497	6,402	3,095	48.3
Segment operating (loss)	\$ (2,425)	\$ (1,018)	\$ (1,407)	(138.2)	\$ (4,048)	\$ (1,776)	\$ (2,272)	(127.9)

The Converged Services segment primarily consists of the operations of NTC, which provides local and long distance voice, data and video services on an exclusive and non-exclusive basis to MDU communities throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi. The Converged Services segment's results were not affected by the restatement detailed in Note 2 to the consolidated financial statements appearing elsewhere in this report.

The number of NTC properties served decreased by 5 net properties, from the second quarter of 2005, due to the Company's continued focus on integrating NTC's operations by evaluating the MDU portfolio and eliminating the smaller unprofitable properties.

Operating Revenues

For the three and six months ended June 30, 2006, service revenues increased \$0.3 million, or 12.4%, and \$0.6 million, or 13.4%, respectively, as a result of the growth in the number of customers served, as compared to the same periods in 2005. Service revenues consist of voice, video and data services at MDU properties in the southeastern United States.

For the three and six months ended June 30, 2006 other revenues increased \$0.1 million, or 726.7%, and \$0.2 million, or 633.3%, respectively, primarily due to an increase in activation fees.

Cost of goods and services

For the three and six months ended June 30, 2006, cost of goods and services increased \$0.6 million, or 40.6%, and \$1.3 million, or 42.7%, respectively, due to a loss on asset disposals of \$0.2 million, for both the three and six months ended June 30, 2006, with the remaining increase primarily the result of network upgrades, maintenance and repairs. Cost of goods and services reflects the cost of purchasing video and voice services, the network costs to provide Internet services to customers and network maintenance and repair. The Company continues to focus on eliminating redundant processes and integrating the operation to reduce the costs of operation.

Selling, general and administrative

For the three and six months ended June 30, 2006, selling, general and administrative expense increased \$0.3 million, or 23.8 %, and \$0.5 million, or 25.8%, respectively, primarily due to a \$0.2 million and \$0.4 million, respectively, increase in customer service expense and a \$0.1 million and \$0.2 million, respectively, increase in advertising expense.

Depreciation and amortization

For the three and six months ended June 30, 2006, depreciation and amortization expense increased \$0.9 million, or 135.3%, and \$1.3 million, or 95.1%, respectively, compared to the same periods in 2005, due primarily to a fourth quarter 2005 change in depreciable lives and, during the second quarter of 2006, the Company recorded \$0.6 million in depreciation expense for four MDU s that notified the Company that they did not intend to renew their contracts for service.

Mobile

(in thousands)	Three Months Ended June 30,				Six Months Ended June 30,			
	2006	2005	Change		2006	2005	Change	
			\$	%			\$	%
	(Restated)				(Restated)			
Segment operating revenues								
Tower lease revenue-affiliate	\$ 416	\$ 344	\$ 72	20.9	\$ 806	\$ 680	\$ 126	18.5
Tower lease revenue-non-affiliate	874	784	90	11.5	1,732	1,545	187	12.1
Other revenue	34	44	(10)	(22.7)	70	73	(3)	4.1
Total segment operating revenues	1,324	1,172	152	13.0	2,608	2,298	310	13.5
Segment operating expenses								
Cost of goods and services, exclusive of depreciation and amortization shown separately below	390	328	62	18.9	805	628	177	28.2
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	162	149	13	8.7	323	311	12	3.9
Depreciation and amortization	210	175	35	20.0	407	351	56	16.0
Total segment operating expenses	762	652	110	16.9	1,535	1,290	245	19.0
Segment operating income	\$ 562	\$ 520	\$ 42	8.1	\$ 1,073	\$ 1,008	\$ 65	6.4

The Mobile company provides tower rental space to affiliated and non-affiliated companies in the Company s PCS markets and paging services throughout the northern Shenandoah Valley.

The results for the three and six months ended June 30, 2005 have been restated to reflect the correction of certain errors in the Company s accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information. The effect of these restatements on the Mobile segment s operating income, for the three and six months ended June 30, 2005, was to decrease tower lease revenue-non-affiliate by \$7 thousand and \$12 thousand, respectively, increase cost of goods and services by \$44 thousand and \$84 thousand, respectively, and decrease segment operating income by \$51 thousand and \$96 thousand, respectively.

At June 30, 2006, the Mobile segment had 108 towers and 152 non-affiliate tenants compared to 90 towers and 142 non-affiliate tenants at June 30, 2005.

For the three and six months ended June 30, 2006, the Mobile Company did not have any additional significant changes from the prior period that need to be discussed.

Liquidity and Capital Resources

The Company has four principal sources of funds available to meet the financing needs of its operations, capital projects, debt service, investments and potential dividends. These sources include cash flows from operations, cash and cash equivalents, the liquidation of investments and borrowings. Management routinely considers the alternatives available to determine what mix of sources are best suited for the long-term benefit of the Company.

Sources and Uses of Cash. The Company generated \$15.7 million of net cash from operations in the six months ended June 30, 2006 compared to \$15.8 million in the comparable period of 2005.

Indebtedness. As of June 30, 2006, the Company's indebtedness totaled \$32.5 million, with an annualized overall weighted average interest rate of approximately 7.3%. As of June 30, 2006, the Company was in compliance with the covenants in its credit agreements.

On August 4, 2005, the board of directors of the Rural Telephone Bank (the RTB) adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

Off-Balance Sheet Transactions. The Company has no off-balance sheet arrangements and has not entered into any transactions involving unconsolidated, limited purpose entities or commodity contracts.

Capital Commitments. During the second quarter of 2006, the Company revised its capital expenditures budgeted for 2006 from a total of \$43.6 million to approximately \$20 million. The 2006 revised budget includes approximately \$4.6 million for additional PCS base stations, additional towers and switch upgrades to enhance the PCS network. Approximately \$5.3 million is budgeted for NTC's network upgrades and new apartment complex build outs, improvements and replacements, approximately \$3.6 million for the telephone operations and approximately \$6.5 million for technology upgrades and other capital needs. For the 2006 six month period, the Company has spent, or has committed to spend, \$12.1 million on capital projects.

The Company believes that cash on hand, cash flow from operations and borrowings expected to be available under the Company's existing revolving credit facility will provide sufficient cash to enable the Company to fund its planned capital expenditures, make scheduled principal and interest payments, meet its other cash requirements and maintain compliance with the terms of its financing agreements for at least the next 12 months. Thereafter, capital expenditures will likely continue to be required to provide increased capacity to meet the Company's expected growth in demand for its products and services. The actual amount and timing of the Company's future capital requirements may differ materially from the Company's estimate depending on the demand for its products and new market developments and opportunities. The Company currently expects that it will fund its future capital expenditures primarily with cash from operations and with borrowings.

These events include, but are not limited to; changes in overall economic conditions, regulatory requirements, changes in technologies, availability of labor resources and capital, changes in the Company's relationship with Sprint Nextel, cancellations or non-renewal of NTC contracts and other conditions. The PCS subsidiary's operations are dependent upon Sprint Nextel's ability to execute certain functions such as billing, customer care, and collections; the subsidiary's ability to develop and implement successful marketing programs and new products and services, and the subsidiary's ability to effectively and economically manage other operating activities under the Company's agreements with Sprint Nextel. The Company's ability to attract and maintain a sufficient customer base is also critical to its ability to maintain a positive cash flow from operations. The foregoing events individually or collectively could affect the Company's results. The Company continues to assess the impact of the planned merger of Sprint Nextel and Nextel Partners on the Company's operations.

The Company has had discussions with Sprint Nextel regarding the continuance of their long-term relationship, the impact of the Sprint Nextel merger and potential changes to the management agreement necessary to reflect the merger of Sprint Corporation and Nextel Communications, Inc and the acquisition of Nextel Partners, Inc. by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require the Company to meet additional program requirements, which the Company anticipates would increase capital expenditures and operating expenses. To date, the Company has

been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, the Company is now going to consider other alternatives in discussions with Sprint Nextel including the possible sale of its PCS business. The Company is unable to predict whether or on what terms it would be able to implement a sale of its PCS business, the ultimate resolution of its discussions with Sprint Nextel concerning its relationship, or the impact of any such action on its financial condition or future operating results or prospects.

Employee Stock Options

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123, Share-Based Payment (Revised 2004) (SFAS 123(R)) using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, for equity classified awards, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized over the requisite service period. For those tandem awards of stock options and stock appreciation rights (SARs) which are liability classified awards, fair value is calculated at the grant date and each subsequent reporting date during both the requisite service period and each subsequent period until settlement.

See Note 5 to the Company s condensed consolidated financial statements for additional information.

Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS 123(R), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) replaces SFAS No. 123, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. The approach in SFAS 123(R) is similar to the approach described in SFAS No. 123, however, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure will no longer be an alternative. SFAS 123(R) was effective for the Company beginning January 1, 2006. The Company recorded a cumulative effect of a change in accounting principle of approximately \$0.1 million as a result of implementing SFAS 123(R) in the first quarter 2006.

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47 Accounting for Conditional Asset Retirement Obligations an Interpretation of FASB Statement No. 143 (FIN No. 47). FIN No. 47 clarifies the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and/or method of settlement are conditional on a future event. FIN No. 47 was effective for the Company as of December 31, 2005. The adoption of FIN No. 47 did not have a material impact on the Company s consolidated results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154). This Statement replaces APB Opinion No. 20, Accounting Changes and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in an accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 was effective for accounting changes and error corrections occurring in fiscal years beginning after December 15, 2005.

In July 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No.109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the enterprise s financial statements in accordance with FASB Statement No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the provisions of FIN 48 and we expect to adopt FIN 48 on January 1, 2007.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company s market risks relate primarily to changes in interest rates on instruments held for other than trading purposes. The Company s interest rate risk involves three components. The first component is outstanding debt with variable rates. As of June 30, 2006, the Company has no variable rate debt outstanding. The Company s debt has fixed rates through maturity. A 10.0% increase in interest rates would decrease the fair value of the Company s total debt by approximately \$0.8 million, while the estimated fair value of the fixed rate debt was approximately \$33.6 million as of June 30, 2006.

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The second component of interest rate risk consists of temporary excess cash, which is primarily invested in overnight repurchase agreements and Treasury bills with a maturity of less than 90 days. The cash is currently invested in short-term investment vehicles that have limited interest rate risk. Management continues to evaluate the most beneficial use of these funds.

The third component of interest rate risk is marked increases in interest rates that may adversely affect the rate at which the Company may borrow funds for growth in the future. Management does not believe that this risk is currently significant because the Company's existing sources of liquidity are adequate to provide cash for operations, payment of debt and near-term capital projects.

Management does not view market risk as having a significant impact on the Company's results of operations, although future results could be adversely affected if interest rates were to increase significantly for an extended period and the Company were to require external financing. General economic conditions affected by regulatory changes, competition or other external influences may pose a higher risk to the Company's overall results.

As of June 30, 2006, the Company has \$7.0 million invested in privately held companies directly or through investments with portfolio managers. Most of the companies are in an early stage of development and significant increases in interest rates could have an adverse impact on their results, ability to raise capital and viability. The Company's market risk is limited to the funds previously invested and an additional \$0.4 million committed under contracts the Company has signed with portfolio managers.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's President and Chief Executive Officer, who is its principal executive officer, and the Company's Executive Vice President and Chief Financial Officer, who is its principal financial officer, conducted an evaluation of the Company's disclosure controls and procedures, as defined by Rule 13a-15(e) under the Securities Exchange Act of 1934, as of June 30, 2006. As previously disclosed under Item 9A. Controls and Procedures in the Company's Form 10-K for its fiscal year ended December 31, 2005, the Company identified material weaknesses in its internal control over financial reporting in accounting for leases and in the calculation of the income tax provision. As further disclosed in that report, and as discussed below, the Company is remediating the two material weaknesses, but the remediation of these weaknesses had not been completed or fully tested as of June 30, 2006. As a result of such material weaknesses, the Company's principal executive officer and its principal financial officer concluded that the Company's disclosure controls and procedures were not effective as of June 30, 2006.

Changes in Internal Control Over Financial Reporting

During the second fiscal quarter of 2006, there were changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting as follows:

To remediate the two material weaknesses in internal control over financial reporting disclosed under Item 9A. Controls and Procedures in the Company's Form 10-K for its fiscal year ended December 31, 2005, the Company is continuing to implement and refine review procedures for existing leases and new leases and is establishing review procedures over the selection of appropriate assumptions and factors affecting lease accounting during the quarter covered by this report. With respect to its accounting for income taxes, the Company is continuing to take steps to ensure that the personnel assigned to such accounting responsibilities have the necessary skills, knowledge and resources. Furthermore, the Company is reviewing its policies and procedures to provide adequate supervisory review of the analysis of income tax accounting amounts.

Other Matters Relating to Internal Control Over Financial Reporting

Under the Company's agreements with Sprint Nextel, Sprint Nextel provides the Company with billing, collections, customer care, certain network operations and other back office services for the PCS operation. As a result, Sprint Nextel remitted to the Company approximately 67% of the Company's total operating revenues for the three months ended June 30, 2006, while approximately 32% of the total operating expenses reflected in the Company's consolidated financial statements for such period relate to charges by or through Sprint Nextel for expenses such as billing, collections and customer care, roaming expense, long-distance, and travel. Due to this relationship, the Company necessarily relies on Sprint Nextel to provide accurate, timely and sufficient data and information to properly record the Company's revenues, expenses and accounts receivable, which underlie a substantial portion of the Company's periodic financial statements and other financial disclosures.

Information provided by Sprint Nextel includes reports regarding the subscriber accounts receivable in the Company's markets. Sprint Nextel provides the Company with monthly accounts receivable, billing and cash receipts information on a market level, rather than a subscriber level. The Company reviews these various reports to identify discrepancies or errors. Under the Company's agreements with Sprint Nextel, the Company is entitled to only a portion of the receipts, net of items such as taxes, government surcharges, certain allocable write-offs and the 8% of revenue retained by Sprint Nextel. Because of the Company's reliance on Sprint Nextel for financial information, the Company must depend on Sprint Nextel to design adequate internal controls with respect to the processes established to provide this data and information to the Company and Sprint Nextel's other Sprint PCS affiliate network partners. To address this issue, Sprint Nextel engages an independent registered public accounting firm to perform a periodic evaluation of these controls and to provide a Report on Controls Placed in Operation and Tests of Operating Effectiveness for Affiliates under guidance provided in Statement of Auditing Standards No. 70 (SAS 70 reports). Historically, the report was provided to the Company on a semi-annual basis and covered a six-month period. The most recent report covers the period from April 1, 2005 to September 30, 2005. The most recent report indicated there were no material issues that would adversely affect the information used to support the recording of the revenues and expenses provided by Sprint Nextel related to the Company's relationship with Sprint Nextel. Sprint Nextel has informed the Company that it will

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not furnish the Company with a semi-annual SAS 70 report for the six-month period from October 1, 2005 through March 31, 2006, but instead will provide a SAS 70 report and review for the nine-month period ending September 30, 2006. Management is monitoring information provided by Sprint Nextel for anomalies and unexpected variances that are not explained by PCS business metrics.

PART II. OTHER INFORMATION

ITEM 1A. Risk Factors

References in this Item 1A to we, us and our are to Shenandoah Telecommunications Company and its consolidated subsidiaries.

As previously discussed, our actual results could differ materially from our forward looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. These and many other factors described in this report and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 could adversely affect our operations, performance and financial condition.

The continued operation of Nextel Partners by Sprint Nextel as a competing network to the Company could have a negative impact on our results of operations and may limit our ability to fully realize any benefits of the merger of Sprint and Nextel.

On August 12, 2005, Sprint Corporation and Nextel Communications, Inc. merged to form Sprint Nextel Corporation. Nextel and its affiliate Nextel Partners, Inc. are providers of digital wireless communications services in our PCS service area. Certain transactions resulting from, or potential effects of, the Sprint Nextel merger discussed below could adversely affect our PCS business as well as our overall results of operations.

Our PCS subsidiary is one of a number of companies we refer to as the Sprint PCS Affiliates, which had entered into substantially similar management and affiliation agreements with Sprint Communications Company L.P. The agreements, including the agreement with Shentel, were with several Sprint entities. In connection with the Sprint Nextel merger, a number of the Sprint PCS Affiliates filed suit against Sprint Nextel alleging that the merger would result in a breach of the exclusivity provisions of their agreements with Sprint Nextel. A number of these legal proceedings are pending. In addition, since the Sprint Nextel merger was announced, Sprint Nextel has acquired several of the Sprint PCS Affiliates.

Prior to the Sprint Nextel merger, we and Sprint Nextel entered into a forbearance agreement setting forth Sprint Nextel's agreement to observe specified limitations in operating Nextel's wireless business in the our PCS service area. The agreement also set forth the Company's agreement not to initiate litigation or seek certain injunctive or equitable relief against Sprint Nextel under certain circumstances, in each case during the period in which the agreement remains in effect. The agreement provided that the statute of limitations on any claims that Shentel might have against Sprint Nextel would be tolled while the agreement remained in effect. Nextel Partners was added to a July 19, 2006 amendment to our forbearance agreement with Sprint Nextel. The forbearance agreement automatically expired on August 4, 2006 in accordance with its terms upon the Court of Chancery of the State of Delaware's issuance of a decision with respect to the pending litigation by some Sprint PCS Affiliates against Sprint Nextel. We are reviewing the court's decision and considering the implications, if any, for us.

We believe that a significant portion of our PCS service area overlaps the service area operated by Nextel Partners under the Nextel brand. On June 26, 2006, Sprint Nextel acquired Nextel Partners. As long as Nextel Partners continues to be operated by Sprint Nextel as a separate business using the Nextel platform, our ability to fully realize any of the benefits from the merger of Sprint and Nextel may be limited. Further, the continued operation by Sprint Nextel of Nextel Partners as a competing network could have a negative impact on our results of operations.

We have had discussions with Sprint Nextel regarding the continuation of our long-term relationship, the impact of the Sprint Nextel merger, and potential changes to the management agreement necessary to reflect the merger of Sprint and Nextel Communications and the acquisition of Nextel Partners by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require us to meet additional program requirements, which we anticipate would significantly increase capital expenditures and operating expenses. To date, we have been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, we are currently considering other alternatives in our ongoing discussions with Sprint Nextel, including the possible sale of our PCS business to Sprint Nextel. We are unable to predict whether or on what terms we would be able to implement a sale of our PCS business, or the ultimate resolution of our discussions with Sprint Nextel concerning our relationship with Sprint Nextel, or the impact of any such sale or other action on our financial condition or future operating results or prospects.

Our access revenue may be adversely impacted by legislative or regulatory actions, or technology developments, that decrease access rates or exempt certain traffic from paying for access to our regulated telephone network.

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The Federal Communications Commission is currently reviewing the issue of access charges as well as an overhaul of intercarrier compensation. An unfavorable change may have an adverse effect on the Company's telephone operations.

Telephone Competition. There has been a trend for incumbent local exchange carriers to see a decrease in access lines due to the effect of wireless and wireline competition and the elimination of second lines dedicated to dial-up Internet as customers migrate to broadband connections. Although the Company has not seen a material reduction in its number of access lines to date, and reported a slight increase during the 2006 six month period, the dominating nationwide trend has been a decline in the number of access lines. There is a significant risk that a downward trend could have a material adverse effect on the Company's telephone operations in the future.

Fiber Facilities. The Company's revenue from fiber leases may be adversely impacted by price competition for these facilities. The Company monitors each of its fiber lease customers to minimize the risk related to this business.

Cable Franchising. The Company operates the cable television system in Shenandoah County, Virginia. The Company has seen increased competition from satellite providers that are larger and have cost advantages over the Company in the procurement of programming. The continued success of the satellite television providers may have an adverse impact on the Company's cable television results.

In 2006, the State of Virginia adopted legislation to make it easier for companies to obtain local franchises to provide cable television service. In addition, Congress is currently considering legislation which would either eliminate the requirement for a local cable television franchise or substantially reduce the cost of obtaining or competing with a local franchise. Any such change, while making it easier for the Company to expand its NTC and cable television business, may also result in increased competition for such businesses.

Net Neutrality. Although the broadband Internet services industry has largely remained unregulated, there has been legislative and regulatory interest in adopting so-called net neutrality principles that could, among other things, prohibit service providers from slowing or blocking access to certain content, applications, or services available on the Internet and otherwise limit their ability to manage their networks efficiently and develop new products and services. The FCC last year adopted a non-binding policy statement expressing its view that consumers are entitled to access lawful Internet content and to run applications and use services of their choice, subject to the needs of law enforcement. If some form of net neutrality legislation or regulations were adopted, it could impair the Company's ability to effectively manage its broadband network and explore enhanced service options for customers.

ITEM 4. Submissions of Matters to a Vote of Security Holders

- (a) The Company held its 2006 annual meeting of shareholders on May 2, 2006.
- (b) The following sets forth information regarding the election of Directors at the 2006 annual meeting. There were 7,701,552 shares of common stock outstanding as of the record date for, and entitled to vote at, the 2006 annual meeting, of which 5,605,126 shares were present in person or by proxy, and constituted a quorum.

The shareholders approved a proposal to elect each of the three nominees to the board of directors for a three-year term, which will expire at the annual meeting of shareholders in 2009. The tabulation of votes on this proposal is as follows:

NOMINEE	FOR
Noel M. Borden	5,484,730
Ken L. Burch	5,514,904
Richard L. Koontz, Jr.	5,426,713

ITEM 6. **Exhibits**

- (a) The following exhibits are filed with this Quarterly Report on Form 10-Q:
- 10.26 Compensation for Non-Employee Directors (incorporated by reference to Exhibit 10.26 to the Company's Current Report on Form 8-K filed on May 3, 2006).
 - 10.27 2006 Management Compensatory Plans and Arrangements (incorporated by reference to Exhibit 10.27 to the Company's Current Report on Form 8-K filed on April 21, 2006).
 - 10.28 Amendment No. 4 to the Sprint/Shenandoah Forbearance Agreement.
 - 31.1 Certification of the President and Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
 - 31.2 Certification of the Executive Vice President and Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
 - 32 Certifications pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. 1350.

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.

SHENANDOAH TELECOMMUNICATIONS COMPANY
(Registrant)

/s/EARLE A. MACKENZIE

Earle A. MacKenzie, Executive Vice President and Chief Financial Officer
Date: August 8, 2006

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<u>32</u>	<u>Certifications pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. 1350.</u>