UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

or

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

For the transition period from to

Commission File Number: 1-12213

COVANCE INC.

(Exact name of Registrant as specified in its Charter)

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act (the Exchange Act) of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO o

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO x

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of October 17, 2008, the Registrant had 63,284,772 shares of common stock outstanding.

Table of Contents

Covance Inc.

Form 10-Q For the Quarterly Period Ended September 30, 2008

INDEX

		Page
Part I. Financial Information		
Item 1.	Financial Statements (Unaudited)	
Consolidated Balance Sheets September 30, 2008 and December 31, 2007		2
Consolidated Statements of Income Three and Nine Months ended September 30, 2008 and 2007		3
Consolidated Statements of Cash Flows Nine Months ended September 30, 2008 and 2007		4
Notes to Consolidated Financial Statements		5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3.	Quantitative and Qualitative Disclosure About Market Risk	26
Item 4.	Controls and Procedures	26
Part II. Other Information		
Item 1a.	Risk Factors	27
Item 6.	Exhibits	32
Signatures		33

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2008 AND DECEMBER 31, 2007

(Dollars in thousands)	September 30, 2008 (UNAUDITED)	December 31, 2007
Assets		
Current Assets:		
Cash and cash equivalents	$ 209,094	$ 319,485
Accounts receivable	240,761	217,657
Unbilled services	103,960	88,835
Inventory	67,644	54,788
Deferred income taxes	9,997	7,825
Prepaid expenses and other current assets	89,324	81,467
Total Current Assets	720,780	770,057
Property and equipment, net	790,429	646,040
Goodwill, net	105,486	105,486
Other assets	38,211	38,602
Total Assets	$ 1,654,906	$ 1,560,185
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 44,677	$ 32,252
Accrued payroll and benefits	91,450	95,313
Accrued expenses and other current liabilities	64,500	66,838
Unearned revenue	145,701	144,870
Short-term debt	23,000	—
Income taxes payable	27,734	18,887
Total Current Liabilities	397,062	358,160
Deferred income taxes	29,111	32,562
Other liabilities	58,694	59,275
Total Liabilities	484,867	449,997
Commitments and Contingent Liabilities		
Stockholders Equity:		
Preferred Stock Par value $1.00 per share; 10,000,000 shares authorized; no shares issued and outstanding at September 30, 2008 and December 31, 2007	—	—
Common Stock - Par value $0.01 per share; 140,000,000 shares authorized; 75,348,104 and 74,590,229 shares issued and outstanding, including those held in treasury, at September 30, 2008 and December 31, 2007, respectively	753	746
Paid-in capital	543,572	492,373
Retained earnings	1,084,188	933,106
Accumulated other comprehensive income	12,321	24,154
Treasury stock at cost (12,094,980 and 10,548,248 shares at September 30, 2008 and December 31, 2007, respectively)	(470,795)	(340,191)
Total Stockholders Equity	1,170,039	1,110,188
Total Liabilities and Stockholders Equity	$ 1,654,906	$ 1,560,185

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

2

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Net revenues	$ 440,109	$ 395,989	$ 1,289,453	$ 1,135,453
Reimbursable out-of-pockets	27,263	18,712	73,779	60,361
Total revenues	467,372	414,701	1,363,232	1,195,814
Cost and expenses:				
Cost of revenue (excluding depreciation and amortization)	287,804	258,355	848,018	743,812
Reimbursed out-of-pocket expenses	27,263	18,712	73,779	60,361
Selling, general and administrative (excluding depreciation and amortization)	64,850	61,089	189,109	174,972
Depreciation and amortization	17,493	16,447	52,172	49,015
Total costs and expenses	397,410	354,603	1,163,078	1,028,160
Income from operations	69,962	60,098	200,154	167,654
Other (income) expense, net:				
Interest income	(1,916)	(2,415)	(6,689)	(7,150)
Interest expense	385	117	1,061	379
Foreign exchange transaction (gain) loss, net	730	(284)	(816)	(238)
Gain on sale of business	—	—	(3,927)	—
Other income, net	(801)	(2,582)	(10,371)	(7,009)
Income before taxes and equity investee earnings	70,763	62,680	210,525	174,663
Taxes on income	20,167	18,469	61,220	51,326
Equity investee earnings	511	403	1,777	1,683
Net income	$ 51,107	$ 44,614	$ 151,082	$ 125,020
Basic earnings per share	$ 0.81	$ 0.70	$ 2.40	$ 1.96
Weighted average shares outstanding - basic	63,055,229	63,711,628	63,065,488	63,718,720
Diluted earnings per share	$ 0.80	$ 0.69	$ 2.36	$ 1.93
Weighted average shares outstanding diluted	63,994,532	64,728,253	64,052,224	64,758,890

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

Table of Contents

COVANCE INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(UNAUDITED)

(Dollars in thousands)	Nine Months Ended September 30 2008		2007	
Cash flows from operating activities:				
Net income	$	151,082	$	125,020
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		52,172		49,015
Non-cash compensation expense associated with employee benefit and stock compensation plans		19,190		21,472
Deferred income tax (benefit) provision		(5,623)		(2,475)
Gain on sale of business		(3,927)		—
Loss (gain) on sale of property and equipment		795		(1,740)
Equity investee earnings		(1,777)		(1,683)
Changes in operating assets and liabilities:				
Accounts receivable		(23,104)		(17,007)
Unbilled services		(15,125)		(15,851)
Inventory		(12,856)		(5,161)
Accounts payable		12,425		6,963
Accrued liabilities		(5,818)		18,901
Unearned revenue		831		12,616
Income taxes payable		11,322		(749)
Other assets and liabilities, net		(6,361)		(13,222)
Net cash provided by operating activities		173,226		176,099
Cash flows from investing activities:				
Capital expenditures		(206,179)		(104,820)
Proceeds from sale of business		3,927		—
Other, net		366		111
Net cash used in investing activities		(201,886)		(104,709)
Cash flows from financing activities:				
Net borrowings under revolving credit facility		23,000		—
Stock issued under employee stock purchase and option plans		29,158		25,948
Purchase of treasury stock		(130,604)		(61,562)
Net cash used in financing activities		(78,446)		(35,614)
Effect of exchange rate changes on cash		(3,285)		4,245
Net change in cash and cash equivalents		(110,391)		40,021
Cash and cash equivalents, beginning of period		319,485		219,810
Cash and cash equivalents, end of period	$	209,094	$	259,831

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

4

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. You should read these unaudited consolidated financial statements together with the historical consolidated financial statements of Covance Inc. and subsidiaries (Covance or the Company) for the years ended December 31, 2007, 2006, and 2005 included in our Annual Report on Form 10-K for the year ended December 31, 2007.

2. Summary of Significant Accounting Policies

Principles of Consolidation

These unaudited consolidated financial statements include the accounts of all entities controlled by Covance. All significant intercompany accounts and transactions are eliminated. The equity method of accounting is used for investments in affiliates in which Covance owns between 20 and 50 percent or has the ability to exercise influence over operating or financial decisions, but, in each case, does not have the ability to exercise control. See Note 4.

Use of Estimates

These unaudited consolidated financial statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Inventory

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

Prepaid Expenses and Other Current Assets

In connection with the management of multi-site clinical trials, Covance pays on behalf of its customers fees to investigators, volunteers and other out-of-pocket costs (such as travel, printing, meetings, couriers, etc.), for which we are reimbursed at cost, without mark-up or profit. Amounts receivable from customers in connection with billed and unbilled investigator fees, volunteer payments and other out-of-pocket pass-through costs are included in prepaid expenses and other current assets in the accompanying consolidated balance sheets and totaled $46.8 million and $47.4 million at September 30, 2008 and December 31, 2007, respectively. See Note 2 Reimbursable Out-of-Pocket Expenses .

Goodwill and Other Intangible Assets and Impairment

Goodwill represents costs in excess of the fair value of net tangible and identifiable net intangible assets acquired in business combinations. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, Covance performs an annual test for impairment of goodwill and other indefinite lived intangible assets during the fourth quarter. This test is performed by comparing, at the reporting unit level, the carrying value of the reporting unit to its fair value. Covance assesses fair value based upon its best estimate of the present value of the future cash flows that it expects to be generated by the reporting unit. The most recent annual test for impairment performed for 2007 did not identify any instances of impairment and there were no events through September 30, 2008 that warranted a reconsideration of our impairment test results.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

Revenue Recognition

Covance recognizes revenue either as services are performed or products are delivered, depending on the nature of the work contracted. Historically, a majority of Covance s net revenues have been earned under contracts which range in duration from a few months to two years, but can extend in duration up to five years or longer. Service contracts generally take the form of fee-for-service or fixed-price arrangements. In cases where performance spans multiple accounting periods, revenue is recognized as services are performed, measured on a proportional performance basis, generally using output measures that are specific to the service provided. Examples of output measures in our early development segment include the number of slides read, dosings performed, or specimens prepared for preclinical laboratory services, or number of dosings or number of volunteers enrolled for clinical pharmacology. Examples of output measures in our late-stage development segment s clinical development service offering include among others, number of investigators enrolled, number of sites initiated, number of patients enrolled and number of monitoring visits completed. Revenue is determined by dividing the actual units of work completed by the total units of work required under the contract and multiplying that percentage by the total contract value. The total contract value, or total contractual payments, represents the aggregate contracted price for each of the agreed upon services to be provided. We do not have any contractual arrangements spanning multiple accounting periods where revenue is recognized on a proportional-performance basis under which we have earned more than an immaterial amount of performance-based revenue (i.e. potential additional revenue tied to specific deliverables or performance). Changes in the scope of work are common, especially under long-term contracts, and generally result in a change in contract value. Once the client has agreed to the changes in scope and renegotiated pricing terms, the contract value is amended and revenue is recognized as described above. Estimates of costs to complete are made to provide, where appropriate, for losses expected on contracts. Costs are not deferred in anticipation of contracts being awarded, but instead are expensed as incurred.

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

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

unearned revenue balance is reduced by the amount of revenue recognized during the period.

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

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

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

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

Taxes on Income

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

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

As of September 30, 2008, the balance of the reserve for unrecognized tax benefits is $10.3 million, of which $3.2 million is recorded as a current liability in accrued expenses and other current liabilities, and $7.1 million is recorded as a long-term liability in other liabilities on the consolidated balance sheet, including accrued interest of $1.5 million. As of December 31, 2007, the balance of the reserve for unrecognized tax benefits was $8.9 million, of which $2.6 million was recorded as a current liability in accrued expenses and other current liabilities, and $6.3 million was recorded as a long-term liability in other liabilities on the consolidated balance sheet, including accrued interest of $1.3 million. This reserve relates to exposures for income tax matters such as transfer pricing, nexus, deemed income and research and development credits.

The Company also maintains a tax reserve related to exposures for non-income tax matters including value-added tax and state sales and use and other taxes, which are accounted for in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. The balance of this reserve at September 30, 2008 and December 31, 2007 is $0.9 million and $0.8 million, respectively, and is recorded as a current liability in accrued expenses and other current liabilities on the consolidated balance sheet.

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

Covance s historical policy has been to leave its unremitted foreign earnings invested indefinitely outside the United States. Except for the one-time opportunity provided under the American Jobs Creation Act, pursuant to which Covance repatriated $103 million in accumulated foreign earnings in the fourth quarter of 2005, Covance intends to continue to leave its unremitted foreign earnings invested indefinitely outside the United States. As a result, taxes have not been provided on any of the remaining accumulated foreign unremitted earnings as of September 30, 2008.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

Comprehensive Income

Covance s total comprehensive income, which represents net income plus the change in the cumulative translation adjustment equity account for the periods presented, was $23.3 million and $54.0 million for the three months ended September 30, 2008 and 2007, respectively, and $139.2 million and $135.8 million for the nine months ended September 30, 2008 and 2007, respectively.

Reimbursable Out-of-Pocket Expenses

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

Stock-Based Compensation

The Company sponsors several stock-based compensation plans pursuant to which non-qualified stock options and restricted stock awards are granted to eligible employees. These plans are described more fully in Note 8 herein and Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The Company recognizes stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payments*, (SFAS 123R) using the modified prospective transition method. Under the modified prospective transition method, compensation expense is recognized in the financial statements on a prospective basis for (a) all share-based payments granted prior to, but not vested as of January 1, 2006, based upon the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and (b) share-based payments granted on or subsequent to January 1, 2006, based upon the grant-date fair value estimated in accordance with the

provisions of SFAS 123R. The grant-date fair value of awards expected to vest is expensed on a straight-line basis over the vesting period of the related awards. See Note 8.

Earnings Per Share (EPS)

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

In computing diluted earnings per share for the three months ended September 30, 2008 and 2007, the denominator was increased by 939,303 shares and 1,016,625 shares, respectively, and for the nine months ended September 30, 2008 and 2007, the denominator was increased by 986,736 shares and 1,040,170 shares, respectively, representing the dilutive effect of stock options outstanding at September 30, 2008 and 2007 with exercise prices less than the average market price of Covance s common stock during each respective period. Excluded from the computation of diluted EPS for the three months ended September 30, 2008 were options to purchase 2,730 shares of common stock at a price of $94.34 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the nine months ended September 30, 2008 were options to purchase 3,978 shares of common stock at prices ranging from $87.33 to $94.34 per share because the exercise prices of such options were greater than

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the three months ended September 30, 2007 were options to purchase 1,200 shares of common stock at prices ranging from $73.32 to $77.90 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period. Excluded from the computation of diluted EPS for the nine months ended September 30, 2007 were options to purchase 10,789 shares of common stock at prices ranging from $66.55 to $77.90 per share because the exercise prices of such options were greater than the average market price of Covance s common stock during this period.

Supplemental Cash Flow Information

Cash paid for interest for the nine month periods ended September 30, 2008 and 2007 totaled $0.9 million and $0.2 million, respectively. Cash paid for income taxes for the nine month periods ended September 30, 2008 and 2007 totaled $44.5 million and $51.5 million, respectively. The change in income taxes payable in the consolidated statement of cash flows for the nine months ended September 30, 2008 and 2007 includes as an operating cash outflow the excess tax benefit received from the exercise of non-qualified stock options as measured under SFAS 123R of $7.2 million and $4.3 million, respectively (a corresponding cash inflow of $7.2 million and $4.3 million, respectively, has been included in financing cash flows).

Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*, (SFAS 158). As of December 31, 2006, Covance has adopted the recognition and disclosure provisions of SFAS 158, which require an employer to recognize the over funded or under funded status of its defined benefit postretirement plans measured as the difference between the fair value of plan assets and the projected benefit obligation - as an asset or liability, respectively, in its balance sheet and to recognize changes in the funded status of the plan in the year in which such changes occur through other comprehensive income. The adoption of SFAS 158 did not have an impact on our consolidated results of operations. SFAS 158 also requires, effective for fiscal years ending after December 15, 2008, that the measurement of the over funded or under funded status of a plan be made as of the employer s fiscal year end and not as of an earlier measurement date. Covance will be required to conform the measurement dates of its plans to December 31st for its fiscal year ending December 31, 2008. Covance does not expect this change in measurement dates to have a material impact on its consolidated results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R) which replaces SFAS No. 141, *Business Combinations*. The scope of SFAS 141R is broader than that of SFAS No. 141, which applied only to business combinations in which control was obtained by transferring consideration. SFAS 141R revises accounting and reporting standards for business combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses by transferring consideration as well as combinations achieved without the transfer of consideration. By applying the same method of accounting the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, this statement is intended to improve the comparability of the information about business combinations provided in financial reports. SFAS 141R applies prospectively to business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Beginning January 1, 2009, Covance will adopt SFAS 141R and the impact of implementing this statement will depend on the nature and significance of business combinations consummated that would be subject to this statement.

On February 12, 2008, the FASB issued FASB Staff Position 157-2 (FSP 157-2), which delays the effective date of the application of SFAS No. 157, *Fair Value Measurements,* (SFAS 157) to fiscal years beginning after November 15, 2008 for all non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. Covance s assets and liabilities subject to the provisions of SFAS 157 are limited to non-recurring non-financial assets such as goodwill and other indefinite lived intangible assets measured at fair value for impairment testing. As such, the adoption of SFAS 157, as amended by FSP 157-2, is deferred until our fiscal year beginning January 1, 2009. Covance does not expect the adoption of SFAS 157, as amended, to have a material impact on its consolidated results of operations or financial position.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

3. Treasury Stock

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

	Nine Months Ended September 30					
	2008			2007		
(amounts in thousands)		**$**	**# shares**		**$**	**# shares**
Shares repurchased in connection with:						
Board approved buyback programs	$	126,709	1,500.0	$	59,628	977.0
Employee benefit plans		3,895	46.7		1,934	30.6
Total	$	130,604	1,546.7	$	61,562	1,007.6

4. Equity Method Investees

Covance has a minority equity position in Noveprim Limited (Noveprim), an existing supplier of research products, which was acquired in March 2004 at a total cost of $20.7 million. The excess of the purchase price over the underlying equity in Noveprim s net assets at the date of acquisition of $13.8 million represents goodwill and is included in the carrying value of Covance s investment. This investment is reflected in other assets on the consolidated balance sheet. During the three and nine month periods ended September 30, 2008, Covance recognized $0.3 million and $1.3 million, respectively, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at September 30, 2008. During the three and nine month periods ended September 30, 2007, Covance recognized $0.3 million and $1.4 million, respectively, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at September 30, 2007. The carrying value of Covance s investment in Noveprim at September 30, 2008 and December 31, 2007 was $22.8 million and $23.2 million, respectively.

Covance has a minority equity position in Bio-Imaging Technologies, Inc. (BITI). BITI uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. During the three and nine month periods ended September 30, 2008, Covance recognized $0.2 million and $0.5 million, respectively, representing its pro rata share of BITI s earnings. During the three and nine month periods ended September 30, 2007,

Covance recognized $0.1 million and $0.3 million, respectively, representing its pro rata share of BITI s earnings. The carrying value of Covance s investment in BITI as of September 30, 2008 and December 31, 2007 was $1.4 million and $0.9 million, respectively, while the fair market value was $18.2 million and $19.0 million, respectively.

5. Divestiture

On November 28, 2007, Covance sold its centralized ECG business (Cardiac Safety Services), part of Covance s late stage development segment, to eResearchTechnology Inc. (eRT) and simultaneously therewith entered into a ten year marketing agreement with eRT under which Covance will continue to offer its clients cardiac safety services. Covance received initial cash proceeds of $35.2 million in connection with the sale and recorded a pre-tax gain of $6.6 million ($4.1 million after tax) during the quarter ended December 31, 2007. During the three months ended September 30, 2008, there were no additional proceeds from this sale reflecting contingent consideration related to transferred backlog and therefore no additional pre-tax gain was recognized in this period. During the nine months ended September 30, 2008, Covance received additional proceeds from this sale reflecting contingent consideration related to transferred backlog totaling $3.9 million and recognized an additional pre-tax gain of $3.9 million ($2.6 million after tax). Covance may receive up to approximately $8.6 million in

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

additional future contingent consideration relating to transferred backlog and revenues generated by eRT from new contracts secured under the first three years of the marketing agreement. In addition, Covance expects to receive referral fees during the term of the long-term marketing agreement.

6. Short-Term Debt

In August 2008, Covance elected to expand its revolving credit facility (the   Credit Facility) to $125.0 million. At September 30, 2008, there were $23.0 million of outstanding borrowings and $1.1 million of outstanding letters of credit under the Credit Facility. At December 31, 2007, there were no outstanding borrowings and $1.1 million of outstanding letters of credit under the Credit Facility. Interest on all outstanding borrowings under the Credit Facility is based upon the London Interbank Offered Rate (LIBOR) plus a 75 basis point margin and approximated 3.23% and 3.33% per annum during the three and nine months ended September 30, 2008, respectively. The Credit Facility, which expires in June 2009, contains various financial and other covenants and is collateralized by guarantees of certain of Covance s domestic subsidiaries and a pledge of 65 percent of the capital stock of certain of Covance s foreign subsidiaries. At September 30, 2008, Covance was in compliance with the terms of the Credit Facility.

7. Defined Benefit Plans

Covance sponsors various pension and other post-retirement benefit plans.

Defined Benefit Pension Plans

Covance sponsors two defined benefit pension plans for the benefit of its employees at two United Kingdom subsidiaries and one defined benefit pension plan for the benefit of its employees at a German subsidiary, all of which are legacy plans of previously acquired companies. Benefit amounts for all three plans are based upon years of service and compensation. The German plan is unfunded while the United Kingdom plans are funded. Covance s funding policy has been to contribute annually a fixed percentage of the eligible employee s salary at least equal to the local statutory funding requirements. Pension plan assets are administered by the plans   trustees and are principally invested in equity and debt securities. The components of net periodic pension expense for these plans for the three and nine month periods ended September 30, 2008 and 2007 are as follows:

	United Kingdom Plans Three Months Ended September 30		German Plan Three Months Ended September 30	
	2008	2007	2008	2007
Components of Net Periodic Pension Cost:				
Service cost	$ 1,268	$ 1,495	$ 136	$ 128
Interest cost	1,897	1,885	127	97
Expected return on plan assets	(2,153)	(2,165)		
Amortization of net actuarial loss	294	358	11	16
Participant contributions	(484)	(565)		
Net periodic pension cost	$ 822	$ 1,008	$ 274	$ 241
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	5.50%	5.25%	5.60%	4.65%
Expected rate of return on assets	6.75%	6.75%	n/a	n/a
Salary increases	4.25%	4.00%	3.00%	2.50%

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

	United Kingdom Plans Nine Months Ended September 30		German Plan Nine Months Ended September 30	
	2008	2007	2008	2007
Components of Net Periodic Pension Cost:				
Service cost	$ 4,030	$ 4,441	$ 428	$ 373
Interest cost	6,035	5,595	404	278
Expected return on plan assets	(6,847)	(6,427)		
Amortization of net actuarial loss	931	1,063	36	51
Participant contributions	(1,542)	(1,675)		
Net periodic pension cost	$ 2,607	$ 2,997	$ 868	$ 702
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	5.50%	5.25%	5.60%	4.65%
Expected rate of return on assets	6.75%	6.75%	n/a	n/a
Salary increases	4.25%	4.00%	3.00%	2.50%

Supplemental Executive Retirement Plan

In addition to these foreign defined benefit pension plans, Covance also has a non-qualified Supplemental Executive Retirement Plan (SERP). The SERP, which is not funded, is intended to provide retirement benefits for certain executive officers of Covance. Benefit amounts are based upon years of service and compensation of the participating employees. The components of net periodic pension cost for the three and nine month periods ended September 30, 2008 and 2007 are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Components of Net Periodic Pension Cost:				
Service cost	$ 309	$ 271	$ 926	$ 814
Interest cost	217	193	651	579
Amortization of prior service cost	(30)	19	(89)	57
Amortization of net actuarial loss	27	10	80	31
Net periodic pension cost	$ 523	$ 493	$ 1,568	$ 1,481
Assumptions Used to Determine Net Periodic Pension Cost:				
Discount rate	5.50%	5.50%	5.50%	5.50%
Salary increases	4.00%	4.00%	4.00%	4.00%

Post-Employment Retiree Health and Welfare Plan

Covance also sponsors a post-employment retiree health and welfare plan for the benefit of eligible employees at certain U.S. subsidiaries who retire after satisfying service and age requirements. This plan is funded on a pay-as-you-go basis and the cost of providing these benefits is shared with the retirees. The components of net periodic post-retirement benefits cost for the three and nine month periods ended September 30, 2008 and 2007 are as follows:

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Components of Net Periodic Post-retirement Benefits Cost:				
Service cost	$ 38	$ 41	$ 115	$ 123
Interest cost	82	70	244	210
Net periodic post-retirement benefits cost	$ 120	$ 111	$ 359	$ 333
Assumptions Used to Determine Net Periodic Post-retirement Benefits Cost:				
Discount rate	5.50%	5.50%	5.50%	5.50%
Health care cost trend rate	9.00%(a)	9.00%(a)	9.00%(a)	9.00%(a)

(a) decreasing to ultimate trend of 5.00% in 2011

8. Stock-Based Compensation Plans

Covance sponsors several employee stock-based compensation plans which are described more fully in Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

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

under the 2002 EEPP at the time the 2007 EEPP was approved. All stock option grants under the 2002 EEPP remaining outstanding are now administered in accordance with the provisions of the 2002 EEPP out of shares issuable under the 2007 EEPP. The Company issues authorized but previously unissued shares when options are exercised or for stock awards. At September 30, 2008 there were approximately 4.4 million shares remaining available for grants or awards under the 2007 EEPP, up to 1.6 million of which are available for issuance as stock awards. There have been no grants of stock appreciation rights or grants to consultants of Covance or entities in which Covance has a controlling or significant equity interest under the 2002 ESOP, the 2002 EEPP or the 2007 EEPP.

The grant-date fair value of stock option awards is estimated using an option pricing model as more fully described in Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. The grant-date fair value of options expected to vest is expensed on a straight-line basis over the vesting period of the related awards.

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

The following table sets forth the weighted-average assumptions used to calculate the fair value of options granted for the three and nine month periods ended September 30, 2008 and 2007:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	**2007**	**2008**	**2007**
Expected stock price volatility	39%	42%	39%	42%
Risk free interest rate(s)	1.9% - 3.7%	4.7% - 5.1%	1.9% - 3.7%	4.7% - 5.1%
Expected life of options (years)	4.4	4.3	4.4	4.3

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

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

Results of operations for the three month period ended September 30, 2008 include total stock-based compensation expense of $6.7 million ($4.5 million net of tax benefit of $2.2 million), $2.5 million of which has been included in cost of revenue and $4.2 million of which has been included in selling, general and administrative expenses. Results of operations for the nine month period ended September 30, 2008 include total stock-based compensation expense of $19.3 million ($13.0 million net of tax benefit of $6.3 million), $7.3 million of which has been included in cost of revenue and $12.0 million of which has been included in selling, general and administrative expenses. Results of operations for the three month period ended September 30, 2007 include total stock-based compensation expense of $5.7 million ($3.8 million net of tax benefit of $1.9 million), $1.9 million of which has been included in cost of revenue and $3.8 million of which has been included in selling, general and administrative expenses. Results of operations for the nine month period ended September 30, 2007 include total stock-based compensation expense of $16.8 million ($11.3 million net of tax benefit of $5.5 million), $5.8 million of which has been included in cost of revenue and $11.0 million of which has been included in selling, general and administrative expenses.

9. Segment Information

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

Table of Contents

COVANCE INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(UNAUDITED)

September 30, 2008 and 2007

(dollars in thousands, unless otherwise indicated)

Segment net revenues, operating income and total assets for the three and nine months ended September 30, 2008 and 2007 are as follows:

	Early Development	Late-Stage Development	Other Reconciling Items	Total
Three months ended September 30, 2008				
Total revenues from external customers	$ 215,390	$ 224,719	$ 27,263(a)	$ 467,372
Operating income	$ 54,846	$ 44,272	$ (29,156)(b)	$ 69,962
Total assets	$ 1,081,422	$ 480,607	$ 92,877(c)	$ 1,654,906
Three months ended September 30, 2007				
Total revenues from external customers	$ 199,486	$ 196,503	$ 18,712(a)	$ 414,701
Operating income	$ 51,777	$ 34,426	$ (26,105)(b)	$ 60,098
Total assets	$ 871,099	$ 472,472	$ 116,356(c)	$ 1,459,927
Nine months ended September 30, 2008				
Total revenues from external customers	$ 630,554	$ 658,899	$ 73,779(a)	$ 1,363,232
Operating income	$ 159,640	$ 126,146	$ (85,632)(b)	$ 200,154
Total assets	$ 1,081,422	$ 480,607	$ 92,877(c)	$ 1,654,906
Nine months ended September 30, 2007				
Total revenues from external customers	$ 569,804	$ 565,649	$ 60,361(a)	$ 1,195,814
Operating income	$ 144,450	$ 95,536	$ (72,332)(b)	$ 167,654
Total assets	$ 871,099	$ 472,472	$ 116,356(c)	$ 1,459,927

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

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

(c) Represents corporate assets.

10. Subsequent Event

On October 3, 2008, Covance acquired Eli Lilly and Company s early development campus in Greenfield, Indiana for approximately $50 million and in connection with this transaction, Covance borrowed an additional $50 million under the Credit Facility.

Table of Contents

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

You should read the following discussion together with the unaudited Covance consolidated financial statements and the accompanying notes included in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

Overview

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

Critical Accounting Policies

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

Revenue Recognition. Covance recognizes revenue either as services are performed or products are delivered, depending on the nature of the work contracted. Historically, a majority of Covance s net revenues have been earned under contracts which range in duration from a few months to two years, but can extend in duration up to five years or longer.

We do not have any individual significant contracts as pertains to revenue recognition. By way of background, at any point in time, we are working on thousands of active client projects, which are governed by individual contracts. In addition, we have not had a single customer who accounted for more than ten percent of our aggregate net revenues during any one of the last three years. In 2007, we served in excess of 300 biopharmaceutical companies and at December 31, 2007, we had over 8,000 active client projects. Most projects are customized based on the needs of the client, the type of services being provided, therapeutic indication of the drug, geographic locations, and other variables. Project specific terms related to pricing, billing milestones, and the scope and type of services to be provided are generally negotiated and contracted on

a project-by-project basis.

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

for losses expected on contracts. Costs are not deferred in anticipation of contracts being awarded, but instead are expensed as incurred. For the three and nine months ended September 30, 2008, we did not experience a change in the estimates used to determine the amounts recognized as revenue (i.e., output measures or costs to complete) for any project resulting in a material impact on our financial position, results of operations or cash flows.

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

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

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

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

Bad Debts. Covance endeavors to assess and monitor the creditworthiness of its customers to which it grants credit terms in the ordinary course of business. Covance maintains a provision for doubtful accounts relating to amounts due that may not be collected. This bad debt provision is monitored on a monthly basis and adjusted as circumstances warrant. Since the recorded bad debt provision is based upon management s judgment, actual bad debt write-offs may be greater or less than the amount recorded. Historically bad debt write-offs have not been material.

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

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

Table of Contents

As of September 30, 2008, the balance of the reserve for unrecognized tax benefits is $10.3 million, of which $3.2 million is recorded as a current liability in accrued expenses and other current liabilities, and $7.1 million is recorded as a long-term liability in other liabilities on the consolidated balance sheet, including accrued interest of $1.5 million. This reserve relates to exposures for income tax matters such as transfer pricing, nexus, deemed income and research and development credits.

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

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

Covance s policy is to provide income taxes on earnings of foreign subsidiaries only to the extent those earnings are taxable or are expected to be remitted. Covance s historical policy has been to leave its unremitted foreign earnings invested indefinitely outside the United States. Except for the amounts repatriated in the fourth quarter of 2005 under the American Jobs Creation Act of 2004, Covance intends to continue to leave its unremitted foreign earnings invested indefinitely outside the United States. As a result, taxes have not been provided on any of the remaining accumulated foreign unremitted earnings as of September 30, 2008.

Stock-Based Compensation. The Company sponsors several stock-based compensation plans pursuant to which non-qualified stock options and restricted stock awards are granted to eligible employees. These plans are described more fully in Note 10 to our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007 and Note 8 to our consolidated financial statements in our Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 included elsewhere herein.

The grant-date fair value of stock awards is based upon the underlying price of the stock on the date of grant. The grant-date fair value of stock option awards must be determined using an option pricing model. Option pricing models require the use of estimates and assumptions as to (a) the expected term of the option, (b) the expected volatility of the price of the underlying stock, (c) the risk-free interest rate for the expected term of the option and (d) pre-vesting forfeiture rates.

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

The following table sets forth the weighted-average assumptions used to calculate the fair value of options granted for the three and nine month periods ended September 30, 2008 and 2007:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	**2007**	**2008**	**2007**
Expected stock price volatility	39%	42%	39%	42%
Risk free interest rate(s)	1.9% - 3.7%	4.7% - 5.1%	1.9% - 3.7%	4.7% - 5.1%
Expected life of options (years)	4.4	4.3	4.4	4.3

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

Table of Contents

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

Covance performs an annual test for impairment of goodwill and other indefinite lived intangible assets during the fourth quarter. This test is performed by comparing, at the reporting unit level, the carrying value of the reporting unit to its fair value. Covance assesses fair value based upon its estimate of the present value of the future cash flows that it expects to be generated by the reporting unit. The most recent test for impairment performed for 2007 did not identify any instances of impairment and there were no events through September 30, 2008 that warranted a reconsideration of our impairment test results. However, changes in expectations as to the present value of the reporting unit s future cash flows might impact subsequent years assessments of impairment.

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

Set forth below is a discussion of the impact that (a) differences between assumed results and actual results and (b) assumption changes have had on our results of operations for the years ended December 31, 2007, 2006 and 2005 and on the financial position of the plans as of December 31, 2007 and 2006 for our United Kingdom defined benefit pension plans (the largest of our defined benefit-type pension plans).

	United Kingdom Plans			
(amounts in millions)	**2007**	**2006**	**2005**	**2004**
Net periodic pension cost	$ 4.0	$ 4.6	$ 4.1	$ 4.3
Weighted average assumptions used to determine net periodic pension cost:				
Discount rate	5.25%	5.00%	5.75%	6.00%
Expected rate of return on assets	6.75%	6.75%	6.75%	6.00%
Salary increases	4.00%	4.00%	4.00%	3.50%

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

	United Kingdom Plans		
(amounts in millions)	**2006 to 2007**	**2005 to 2006**	**2004 to 2005**

	2007	2006	2005
Change in discount rate	$ (1.3)	$ 2.4	$ 0.4
Change in expected rate of return on assets			(0.6)
Change in rate of salary increases			0.4
Other, including differences between actual experience and assumptions used	0.3	(1.9)	(0.4)
Foreign currency exchange rate changes	0.4		
Net change in periodic benefit cost	$ (0.6)	$ 0.5	$ (0.2)

	United Kingdom Plans		
	2007	**2006**	**2005**
Weighted average assumptions used to determine benefit obligation:			
Discount rate	5.50%	5.25%	5.00%
Salary increases	4.25%	4.00%	4.00%

Table of Contents

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

(amounts in millions)	United Kingdom Plans 2006 to 2007	United Kingdom Plans 2005 to 2006
Projected benefit obligation, beginning of year	$ 141.3	$ 119.8
Service/interest cost components of net periodic benefit cost in year	13.5	12.2
Benefits paid	(2.1)	(1.3)
Increase in discount rate	(8.5)	(8.6)
Other, including differences between actual experience and assumptions used	6.3	3.9
Foreign currency exchange rate changes	1.6	15.3
Projected benefit obligation, end of year	$ 152.1	$ 141.3

Foreign Currency Risks

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

We also have other cross-currency contracts executed by other Covance subsidiaries where the foreign currency amounts billed are determined by converting local currency revenue amounts to the contract billing currency using the exchange rates in effect at the time services are rendered. These contracts do not give rise to foreign currency denominated revenue and local currency denominated expenses, but they do give rise to a second type of risk. This second type of risk results from the passage of time between the invoicing of customers under both of these types of contracts and the ultimate collection of customer payments against such invoices. Because such invoices are denominated in a currency other than the subsidiary s local currency, Covance recognizes a receivable at the time of invoicing for the local currency equivalent of the foreign currency invoice amount as of the invoice date. Subsequent changes in exchange rates from the time the invoice is prepared to the time payment from the customer is received will result in Covance receiving either more or less in local currency than the local currency equivalent of the invoice amount at the time the invoice was prepared and the receivable was recorded. This difference is recognized by Covance as a foreign currency transaction gain or loss, as applicable, in the consolidated statements of income.

Finally, Covance s consolidated financial statements are denominated in U.S. dollars. Accordingly, changes in exchange rates between the applicable foreign currency and the U.S. dollar will affect the translation of each foreign subsidiary s financial results into U.S. dollars for purposes of reporting Covance s consolidated financial results. The process by which each foreign subsidiary s financial results are translated into U.S. dollars is as follows: income statement accounts are translated at average exchange rates for the period; balance sheet asset and liability accounts are translated at end of period exchange rates; and equity accounts are translated at historical exchange rates. Translation of the balance sheet in this manner affects the stockholders equity account, referred to as the cumulative translation adjustment account. This account exists only in the foreign subsidiary s U.S. dollar balance sheet and is necessary to keep the foreign balance sheet stated in U.S. dollars in balance. At September 30, 2008, accumulated other comprehensive income on the consolidated balance sheet includes the cumulative translation account balance of $33.5 million.

Operating Expenses and Reimbursable Out-of-Pockets

Covance segregates its recurring operating expenses among four categories: cost of revenue; reimbursed out-of-pocket expenses; selling, general and administrative expenses; and depreciation and amortization. Cost of revenue includes direct labor and related benefits, other direct costs, shipping and handling fees, and an allocation of facility charges and information technology costs, and excludes depreciation and amortization. Cost of revenue, as a percentage of net revenues, tends and is expected to

Table of Contents

fluctuate from one period to another, as a result of changes in labor utilization and the mix of service offerings involving hundreds of studies conducted during any period of time. Selling, general and administrative expenses consist primarily of administrative payroll and related benefit charges, advertising and promotional expenses, administrative travel and an allocation of facility charges and information technology costs, and excludes depreciation and amortization.

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

Quarterly Results

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

Results of Operations

Three Months Ended September 30, 2008 Compared with Three Months Ended September 30, 2007. Net revenues increased 11.1%, or 9.6% excluding the favorable impact of foreign exchange rate variances between both periods, to $440.1 million for the three months ended September 30, 2008 from $396.0 million for the corresponding 2007 period. Net revenues from Covance s early development segment grew 8.0%, or 8.8% excluding the unfavorable impact of foreign exchange rate variances between both periods. Growth in the segment was driven by a 9.9% increase in net revenues in our preclinical laboratory services, resulting from an increase in available capacity due to our facility expansions, sustained high levels of client satisfaction resulting in more repeat business, and favorable market conditions. Net revenues from Covance s late-stage development segment grew 14.4%, or 10.5% excluding the favorable impact of foreign exchange rate variances between both periods. Growth in the segment was led by a strong performance in our central laboratory services, where net revenues grew 21.0% on increased investigator and patient enrollment, overall higher level of study activity and the favorable impact of foreign exchange rate variances between both periods. Also contributing to growth was a strong performance in our clinical development services, where net revenues grew 26.8% on increased study activity and the favorable impact of foreign exchange rate variances between both periods. Negatively impacting growth over the prior year was the divestiture of our cardiac safety service offering in November 2007, which contributed $7.4 million of net revenue in the three months ended September 30, 2007.

Cost of revenue increased 11.4% to $287.8 million or 65.4% of net revenues for the three months ended September 30, 2008 as compared to $258.4 million or 65.2% of net revenues for the corresponding 2007 period. Gross margins decreased by 20 basis points to 34.6% for the three months ended September 30, 2008 from 34.8% for the corresponding 2007 period.

Overall, selling, general and administrative expenses increased 6.2% to $64.9 million for the three months ended September 30, 2008 from $61.1 million for the corresponding 2007 period. As a percentage of net revenues, selling, general and administrative expenses decreased 70 basis points to 14.7% for the three month period ended September 30, 2008 from 15.4% for the corresponding 2007 period. This percentage can vary from quarter to quarter depending on the timing and nature of various professional fees and other discretionary spending. The 70 basis point decrease over the corresponding 2007 period also reflects increased efficiencies gained from the leveraging of our existing support functions across a larger base of revenues.

Depreciation and amortization increased 6.4% to $17.5 million or 4.0% of net revenues for the three months ended September 30, 2008 from $16.4 million or 4.2% of net revenues for the corresponding 2007 period primarily as a result of higher levels of capital spending related to assets placed into service over the last fifteen months.

Income from operations increased 16.4% to $70.0 million or 15.9% of net revenues for the three months ended September 30, 2008 from $60.1 million or 15.2% of net revenues for the corresponding 2007 period. Income from operations from Covance s early development segment increased $3.1 million or 5.9% to $54.8 million or 25.5% of net revenues for the three months ended September 30, 2008 from $51.8 million or 26.0% of net revenues for the corresponding 2007 period. The $3.1 million increase in the segment over the prior year was driven by additional income from operations resulting from the 9.9% growth in preclinical laboratory services net revenues explained above. Income from operations from Covance s late-stage development segment increased $9.8 million or 28.6% to $44.3 million or 19.7% of net revenues for the three months ended September 30, 2008 from $34.4 million or 17.5% of net revenues for the corresponding 2007 period. Growth was driven by central laboratory and clinical development services, where income from operations grew 23.5% and 134.5%, respectively, over the prior year primarily on the increase in net revenues explained above. Additionally contributing to the clinical development services growth in operating income was increased efficiency gained from leveraging existing support functions across a larger base of revenues. Partially offsetting the growth from central laboratory and clinical was weakness in our commercialization services, where operating margin declined 31.5% over the prior year due to a decline in net revenues. Corporate expense increased $3.1 million to $29.2 million or 6.6% of net revenues for the three months ended September 30, 2008 from $26.1 million or 6.6% of net revenues for the three months ended September 30, 2007. Included in Corporate expense is stock-based compensation expense of $6.7 million or 1.5% of net revenues for the three months ended September 30, 2008, as compared to $5.7 million or 1.4% of net revenues for the corresponding 2007 period. The higher level of Corporate expenses for the three months ended September 30, 2008 as compared to the corresponding 2007 period also reflects an increase in compensation-related expenses and investments in infrastructure to support higher levels of current and expected future growth.

Other income, net decreased $1.8 million to $0.8 million for the three months ended September 30, 2008 from $2.6 million for the corresponding 2007 period. This decrease is driven by fluctuations in foreign exchange rates resulting in net foreign exchange transaction losses totaling $0.7 million during the three month period ended September 30, 2008 compared to net foreign exchange transaction gains totaling $0.3 million during corresponding 2007 period. Additionally, interest income decreased $0.5 million compared to the corresponding 2007 period due to a decrease in invested cash balances coupled with lower interest rates on those balances.

Covance s effective tax rate for the three months ended September 30, 2008 was 28.5% compared to 29.5% for the corresponding 2007 period. The year over year decrease in Covance s effective tax rate is attributable to a number of factors, including the mix of our pre-tax earnings across various tax jurisdictions and other planning initiatives.

Covance has a minority equity position in Bio-Imaging Technologies, Inc. (BITI). BITI uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. For the three month periods ended September 30, 2008 and 2007, Covance recognized income of $0.2 million and $0.1 million, respectively, representing its pro rata share of BITI s earnings.

Covance has a minority equity position in Noveprim Limited (Noveprim), a supplier of research products. For each of the three month periods ended September 30, 2008 and 2007, Covance recognized $0.3 million, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at September 30, 2008 and 2007.

Net income of $51.1 million for the three months ended September 30, 2008 increased $6.5 million or 14.6% as compared to $44.6 million for the corresponding 2007 period.

Nine Months Ended September 30, 2008 Compared with Nine Months Ended September 30, 2007. Net revenues increased 13.6%, or

10.7% excluding the favorable impact of foreign exchange rate variances between both periods, to $1.29 billion for the nine months ended September 30, 2008 from $1.14 billion for the corresponding 2007 period. Net revenues from Covance s early development segment grew 10.7%, or 10.3% excluding the favorable impact of foreign exchange rate variances between both periods. Growth in the segment was driven by a 12.5% increase in net revenues in our preclinical laboratory services, resulting from an increase in available capacity due to our facility expansions, sustained high levels of client satisfaction resulting in more repeat business, and favorable market conditions. Net revenues from Covance s late-stage development segment increased 16.5%, or 11.1% excluding the favorable impact of foreign exchange rate variances between both periods. Growth in the segment was led by a strong performance in our central laboratory services, where net revenues grew 27.0% on increased investigator and patient enrollment, overall higher level of study activity and the favorable

impact of foreign exchange rate variances between both periods. Also contributing to growth was a strong performance in our clinical development services, where net revenues grew 21.0% on increased study activity and the favorable impact of foreign exchange rate variances between both periods. Negatively impacting growth over the prior year was the divestiture of our cardiac safety service offering in November 2007, which contributed $19.1 million of net revenue in the nine months ended September 30, 2007.

Cost of revenue increased 14.0% to $848.0 million or 65.8% of net revenues for the nine months ended September 30, 2008 as compared to $743.8 million or 65.5% of net revenues for the corresponding 2007 period. Gross margins decreased by 30 basis points to 34.2% for the nine months ended September 30, 2008 from 34.5% for the corresponding 2007 period.

Overall, selling, general and administrative expenses increased 8.1% to $189.1 million for the nine months ended September 30, 2008 from $175.0 million for the corresponding 2007 period. As a percentage of net revenues, selling, general and administrative expenses decreased 70 basis points to 14.7% for the nine months ended September 30, 2008 from 15.4% for the corresponding 2007 period. This percentage can vary from quarter to quarter depending on the timing and nature of various professional fees and other discretionary spending. The 70 basis point decrease over the corresponding 2007 period also reflects increased efficiencies gained from the leveraging of our existing support functions across a larger base of revenues.

Depreciation and amortization increased 6.4% to $52.2 million or 4.0% of net revenues for the nine months ended September 30, 2008 from $49.0 million or 4.3% of net revenues for the corresponding 2007 period primarily as a result of higher levels of capital spending related to assets placed into service over the last fifteen months.

Income from operations increased 19.4% to $200.2 million or 15.5% of net revenues for the nine months ended September 30, 2008 from $167.7 million or 14.8% of net revenues for the corresponding 2007 period. Income from operations from Covance s early development segment increased $15.2 million or 10.5% to $159.6 million or 25.3% of net revenues for the nine months ended September 30, 2008 from $144.4 million or 25.4% of net revenues for the corresponding 2007 period. The $15.2 million increase in the segment over the prior year was driven by additional income from operations resulting from the 12.5% growth in preclinical laboratory services net revenues explained above. Income from operations from Covance s late-stage development segment increased $30.6 million or 32.0% to $126.1 million or 19.1% of net revenues for the nine months ended September 30, 2008 from $95.5 million or 16.9% of net revenues for the corresponding 2007 period. Growth was driven by central laboratory and clinical development services, where income from operations grew 43.0% and 38.9%, respectively, over the prior year primarily on the increase in net revenues explained above. Partially offsetting the growth from central laboratory and clinical was weakness in our commercialization services, where operating margin declined 25.9% over the prior year on a decline in net revenues. Corporate expense increased $13.3 million to $85.6 million or 6.6% of net revenue for the nine months ended September 30, 2008 from $72.3 million or 6.4% of net revenue for the nine months ended September 30, 2007. Included in Corporate expense is stock-based compensation expense of $19.3 million or 1.5% of net revenues for the nine months ended September 30, 2008, as compared to $16.8 million or 1.5% of net revenues for the corresponding 2007 period. The higher level of Corporate expenses for the nine months ended September 30, 2008 as compared to the corresponding 2007 period also reflects an increase in compensation-related expenses and investments in infrastructure to support higher levels of current and expected future growth.

Other income, net increased $3.4 million to $10.4 million for the nine months ended September 30, 2008 from $7.0 million for the corresponding 2007 period. Included in other income in the 2008 period is an additional $3.9 million gain from the receipt of contingent consideration on transferred backlog on the November 2007 sale of Covance s cardiac safety service offering and a $0.6 million increase in foreign exchange transaction gains. Partially offsetting these increases is a $0.5 million decrease in interest income compared to the corresponding 2007 period due to a decrease in invested cash balances coupled with lower interest rates on those balances.

Covance s effective tax rate for the nine months ended September 30, 2008 was 29.1% compared to 29.4% for the corresponding 2007 period. The year over year decrease in Covance s effective tax rate is attributable to a number of factors, including the mix of our pre-tax earnings across various tax jurisdictions and other planning initiatives, partially offset by the higher effective tax rate on the gain on sale of business.

Covance has a minority equity position in Bio-Imaging Technologies, Inc. (BITI). BITI uses proprietary medical imaging technologies to process and analyze medical images, and also provides other services, including the data-basing and regulatory submission of medical images, quantitative data and text. During the nine month periods ended September 30, 2008

Table of Contents

and 2007, Covance recognized income of $0.5 million and $0.3 million, respectively, representing its pro rata share of BITI s earnings.

Covance has a minority equity position in Noveprim Limited (Noveprim), a supplier of research products. For the nine month periods ended September 30, 2008 and 2007, Covance recognized $1.3 million and $1.4 million, respectively, representing its share of Noveprim s earnings, less the elimination of profit on inventory purchased from Noveprim and still on hand at Covance at September 30, 2008 and 2007.

Net income of $151.1 million for the nine months ended September 30, 2008 increased $26.1 million or 20.8% as compared to $125.0 million for the corresponding 2007 period.

Liquidity and Capital Resources

Cash and cash equivalents at September 30, 2008 and December 31, 2007 were $209.1 million and $319.5 million, respectively. Amounts are principally invested in short-term money market funds and bank deposits. Covance s expected primary cash needs on both a short and long-term basis are for capital expenditures, expansion of services, possible future acquisitions, geographic expansion, working capital and other general corporate purposes, including possible share repurchases. On August 12, 2008, Covance s revolving credit facility (the Credit Facility), which expires in June 2009, was expanded to $125.0 million at Covance s election. Covance believes cash on hand plus cash from operations and available borrowings under the Credit Facility will provide sufficient liquidity for the foreseeable future. At September 30, 2008, there were $23.0 million of outstanding borrowings and $1.1 million of outstanding letters of credit under the Credit Facility. At December 31, 2007, there were no outstanding borrowings and $1.1 million of outstanding letters of credit under the Credit Facility. Interest on all outstanding borrowings under the Credit Facility is based upon the London Interbank Offered Rate (LIBOR) plus a 75 basis point margin and approximated 3.33% per annum during the nine months ended September 30, 2008. The Credit Facility contains various financial and other covenants. At September 30, 2008, Covance was in compliance with the terms of the Credit Facility. The Credit Facility is collateralized by guarantees of certain of Covance s domestic subsidiaries and a pledge of 65 percent of the capital stock of certain of Covance s foreign subsidiaries.

During the nine months ended September 30, 2008, Covance s operations provided net cash of $173.2 million, a decrease of $2.9 million from the corresponding 2007 period. The change in net operating assets used $38.7 million in cash during the nine months ended September 30, 2008, primarily due to an increase in accounts receivable, unbilled services and inventory, partially offset by an increase in accounts payable. The change in net operating assets used $13.5 million in cash during the nine months ended September 30, 2007, primarily due to an increase in accounts receivable, unbilled services and other current assets, partially offset by an increase in accrued expenses and unearned revenue. Covance s ratio of current assets to current liabilities was 1.82 at September 30, 2008 and 2.15 at December 31, 2007.

Investing activities for the nine months ended September 30, 2008 used $201.9 million, compared to using $104.7 million for the corresponding 2007 period. Capital spending for the first nine months of 2008 totaled $206.2 million, and was primarily for the expansion of our preclinical facilities in North America and Europe, outfitting of new facilities, upgrade of existing equipment, and the purchase of new equipment, hardware and software. Approximately $171.2 million of capital spending in the first nine months of 2008 represents expenditures primarily related to ongoing significant facility expansions and transformational information technology projects that have not yet been placed in service. Capital spending for the corresponding 2007 period totaled $104.8 million, and was primarily for the expansion of our preclinical facilities in North America and Europe, outfitting of new facilities, upgrade of existing equipment, and the purchase of new equipment, hardware and software for newly hired employees. Investing activities for the nine months ended September 30, 2008 also included $3.9 million of additional proceeds received during the period reflecting contingent consideration related to transferred backlog from the sale of Covance s cardiac safety service offering on November 28, 2007.

Financing activities for the nine months ended September 30, 2008 and 2007 used $78.4 million and $35.6 million, respectively. During the nine months ended September 30, 2008, $126.7 million was used to purchase into treasury 1,500,000 shares of common stock under the share buyback program authorized by Covance s Board of Directors and $3.9 million was used to purchase into treasury 46,732 shares of common stock in connection with employee benefit plans; partially offset by $17.0 million in proceeds from the exercise of stock options, $4.9 million from employee contributions to the Company s employee stock purchase plan and $7.2 million in excess tax benefits realized on the exercise of stock options. Additionally, Covance borrowed $43.0 million under the Credit Facility during the first quarter of 2008 to partially fund the purchase into treasury of common stock and repaid $20.0 million of these borrowings during the second and third quarters of 2008, for net borrowings of $23.0 million during the first nine months of 2008. During the nine months ended September 30,

Table of Contents

2007, $59.6 million was used to purchase into treasury 977,000 shares of common stock under the share buyback program authorized by Covance s Board of Directors and $1.9 million was used to purchase into treasury 30,573 shares of common stock in connection with employee benefit plans; partially offset by $17.7 million in proceeds from the exercise of stock options, $4.3 million in excess tax benefits realized on the exercise of stock options and $4.0 million from employee contributions to the Company s employee stock purchase plan.

In October 2008, Covance borrowed an additional $50 million under the Credit Facility in connection with the purchase of Eli Lilly and Company s early drug development campus in Greenfield, Indiana.

Inflation

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

Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R),* (SFAS 158). As of December 31, 2006, Covance has adopted the recognition and disclosure provisions of SFAS 158, which require an employer to recognize the over funded or under funded status of its defined benefit postretirement plans measured as the difference between the fair value of plan assets and the projected benefit obligation - as an asset or liability, respectively, in its balance sheet and to recognize changes in the funded status of the plan in the year in which such changes occur through other comprehensive income. The adoption of SFAS 158 did not have an impact on our consolidated results of operations. SFAS 158 also requires, effective for fiscal years ending after December 15, 2008, that the measurement of the over funded or under funded status of a plan be made as of the employer s fiscal year end and not as of an earlier measurement date. Covance will be required to conform the measurement dates of its plans to December 31st for its fiscal year ending December 31, 2008. Covance does not expect this change in measurement dates to have a material impact on its consolidated results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R) which replaces SFAS No. 141, *Business Combinations*. The scope of SFAS 141R is broader than that of SFAS No. 141, which applied only to business combinations in which control was obtained by transferring consideration. SFAS 141R revises accounting and reporting standards for business combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses by transferring consideration as well as combinations achieved without the transfer of consideration. By applying the same method of accounting the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, this statement is intended to improve the comparability of the information about business combinations provided in financial reports. SFAS 141R applies prospectively to business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Beginning January 1, 2009, Covance will adopt SFAS 141R and the impact of implementing this statement will depend on the nature and significance of business combinations consummated that would be subject to this statement.

On February 12, 2008, the FASB issued FASB Staff Position 157-2 (FSP 157-2), which delays the effective date of the application of SFAS No. 157, *Fair Value Measurements,* (SFAS 157) to fiscal years beginning after November 15, 2008 for all non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. Covance s assets and liabilities subject to the provisions of SFAS 157 are limited to non-recurring non-financial assets such as goodwill and other indefinite lived intangible assets measured at fair value for impairment testing. As such, the adoption of SFAS 157, as amended by FSP 157-2, is deferred until our fiscal year beginning January 1, 2009. Covance does not expect the adoption of SFAS 157, as amended, to have a material impact on its consolidated results of operations or financial position.

Table of Contents

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

Item 3. Quantitative and Qualitative Disclosure About Market Risk

For the nine months ended September 30, 2008, approximately 41% of our net revenues were derived from our operations outside the United States. We do not engage in material or long-term derivative or hedging activities related to our potential foreign exchange exposures. See Management s Discussion and Analysis of Financial Condition and Results of Operations Foreign Currency Risks for a more detailed discussion of our foreign currency risks and exposures.

Covance s short-term investments are with major financial institutions in countries whose governments guarantee those investments (primarily in Ireland and the United Kingdom). These short-term investments are in bank deposits and money market funds which can be readily purchased and sold using established markets. Covance s cash investment policy is to maximize utilization of excess cash by following specific criteria as follows (in order of priority): (1) preserve capital (minimize financial market risk); (2) maintain liquidity; (3) manage foreign exchange rate exposure (internal hedging); (4) maximize rate of return; and (5) enhance strategic relationships with select financial institutions. Covance also has strong operating cash flow and ready access to credit available under its Credit Facility, as evidenced by its recent ability to expand the Credit Facility to $125 million in August 2008 and its ability to borrow $50 million under the Credit Facility in early October 2008.

Item 4. Controls and Procedures

Disclosure controls and procedures. The Company s Principal Executive Officer and Principal Financial Officer have reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures as of the end of the period covered in this report. Based on that evaluation, the Principal Executive Officer and the Principal Financial Officer have concluded that the Company s current disclosure controls and procedures are effective. There have been no significant changes in the Company s internal controls or in the other factors that significantly affect those controls.

Table of Contents

Part II. Other Information

Item 1a. Risk Factors

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

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

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

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

Any failure on our part to comply with applicable regulations could result in the termination of on-going research or the disqualification of data for submission to regulatory authorities. For example, if we were to fail to properly monitor compliance by clinical trial investigators with study protocols, the data collected from that trial could be disqualified. If this were to happen, we could be contractually required to repeat the trial at no further cost to our customer, but at substantial cost to us.

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

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

- the failure of products to satisfy safety requirements;

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

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

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

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

Table of Contents

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

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

Our quarterly operating results may vary.

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

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

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

We depend on the pharmaceutical and biotechnology industries.

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

We operate in a highly competitive industry.

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

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

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

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

Table of Contents

We may expand our business through acquisitions.

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

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

We may be affected by potential health care reform.

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

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

We rely on third parties for important services.

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

Our revenues and earnings are exposed to exchange rate fluctuations.

We derive a large portion of our net revenues from international operations. For the nine month period ended September 30, 2008, we derived approximately 41% of our net revenues from outside the United States. Our financial statements are denominated in U.S. dollars. In addition, in certain circumstances, we may incur costs in one currency related to our services or products for which we are paid in a different currency. As a result, factors associated with international operations, including changes in foreign currency exchange rates, could significantly affect our results of operations, financial condition and cash flows.

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

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

Table of Contents

Contract research services create a risk of liability.

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

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

We also contract with physicians, also referred to as investigators, to conduct the clinical trials to test new drugs on human volunteers. These tests can create a risk of liability for personal injury or death to volunteers, resulting from negative reactions to the drugs administered or from professional malpractice by third party investigators. We believe that our risks in this area are generally reduced by the following:

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

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

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

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

Reliance on facilities.

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

Table of Contents

Reliance on air transportation.

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

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

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

Actions of animal rights extremists may affect our business.

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

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

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

Table of Contents

Item 6. Exhibits

31.1	Certification Joseph L. Herring. ***Filed herewith.***
31.2	Certification William E. Klitgaard. ***Filed herewith.***
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Joseph L. Herring. ***Filed herewith.***
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 William E. Klitgaard. ***Filed herewith.***

Table of Contents

SIGNATURES

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

COVANCE INC.

Dated: October 31, 2008	By: /s/ Joseph L. Herring Joseph L. Herring Chairman of the Board and Chief Executive Officer

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

Signature	**Title**	**Date**
/s/ Joseph L. Herring Joseph L. Herring	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	October 31, 2008
/s/ William E. Klitgaard William E. Klitgaard	Corporate Senior Vice President and Chief Financial Officer (Principal Financial Officer)	October 31, 2008
/s/ Michele A. Kennedy Michele A. Kennedy	Corporate Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer)	October 31, 2008

Table of Contents

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