

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

FORM 10-Q

Mark One

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

For the Quarterly Period ended September 30, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 0-24249

PDI, INC.
(Exact name of Registrant as specified in its charter)

Delaware	22-2919486
-----	-----
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Saddle River Executive Centre
1 Route 17 South
Saddle River, New Jersey 07458

(Address of principal executive offices)

(201) 258-8450

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.)

Yes No

As of October 29, 2004 the Registrant had a total of 14,687,469 shares of Common Stock, \$.01 par value, outstanding.

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PDI, INC.

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PDI, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

September 30, December 31,
2004 2003

ASSETS

Current assets:		
Cash and cash equivalents	\$ 77,284	\$ 113,288
Short-term investments	29,032	1,344
Inventory, net	--	43
Accounts receivable, net of allowance for doubtful accounts of \$349 and \$749 as of September 30, 2004 and December 31, 2003, respectively	22,932	40,885
Unbilled costs and accrued profits on contracts in progress	2,442	4,041
Deferred training and other program costs	1,656	1,643
Other current assets	10,836	8,847
Deferred tax asset	3,900	11,053
	-----	-----
Total current assets	148,082	181,144
Net property and equipment	18,369	14,494
Deferred tax asset	6,797	7,304
Goodwill	21,759	11,132
Other intangible assets	20,021	1,648
Other long-term assets	3,833	3,901
	-----	-----
Total assets	\$ 218,861	\$ 219,623
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 3,394	\$ 8,689

Accrued returns	4,602	22,811
Accrued incentives	17,149	20,486
Accrued salaries and wages	8,897	9,031
Unearned contract revenue	9,809	3,604
Restructuring accruals	321	744
Income taxes and other accrued expenses	15,422	15,770
	-----	-----
Total current liabilities	59,594	81,135
Total long-term liabilities	--	--
	-----	-----
Total liabilities	59,594	81,135

Commitments and Contingencies (note 13)

Stockholders' equity:

Preferred stock, \$.01 par value, 5,000,000 shares authorized, no shares issued and outstanding	--	--
Common stock, \$.01 par value, 100,000,000 shares authorized: shares issued and outstanding, September 30, 2004 - 14,625,537, and December 31, 2003 - 14,387,126; 161,115 and 136,178 restricted shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	148	145
Additional paid-in capital	115,492	109,531
Retained earnings	45,990	29,505
Accumulated other comprehensive income	47	25
Unamortized compensation costs	(2,300)	(608)
Treasury stock, at cost: 5,000 shares	(110)	(110)
	-----	-----
Total stockholders' equity	159,267	138,488
	-----	-----
Total liabilities & stockholders' equity	\$ 218,861	\$ 219,623
	=====	=====

The accompanying notes are an integral part
of these financial statements

PDI, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(restated)		(restated)	
	<C>	<C>	<C>	<C>
Revenue				
Service	\$ 92,525	\$94,470	\$277,666	\$245,111
Product, net	(3)	81	(1,034)	197
	-----	-----	-----	-----
Total revenue	92,522	94,551	276,632	245,308
	-----	-----	-----	-----
Cost of goods and services				
Program expenses (including related party amounts of \$0 and \$653 for the quarters ended September 30, 2004 and 2003, respectively and \$180 and \$1,287 for the nine months ended September 30, 2004 and 2003, respectively)	68,127	70,085	203,670	182,227
Cost of goods sold	10	952	244	1,097
	-----	-----	-----	-----
Total cost of goods and services	68,137	71,037	203,914	183,324
	-----	-----	-----	-----

Gross profit	24,385	23,514	72,718	61,984	
Compensation expense	8,409	9,297	26,549	27,294	
Other selling, general and administrative expenses	6,941	7,676	19,089	20,714	
Restructuring and other related expenses	--	--	--	(270)	
Litigation settlement	--	--	--	2,100	
	-----	-----	-----	-----	
Total operating expenses	15,350	16,973	45,638	49,838	
	-----	-----	-----	-----	
Operating income	9,035	6,541	27,080	12,146	
Other income, net	231	246	860	741	
	-----	-----	-----	-----	
Income before provision for taxes	9,266	6,787	27,940	12,887	
Provision for income taxes	3,799	2,605	11,455	5,115	
	-----	-----	-----	-----	
Net income	\$ 5,467	\$ 4,182	\$ 16,485	\$ 7,772	
	=====	=====	=====	=====	
Basic net income per share	\$ 0.37	\$ 0.29	\$ 1.13	\$ 0.55	
	=====	=====	=====	=====	
Diluted net income per share	\$ 0.37	\$ 0.29	\$ 1.11	\$ 0.54	
	=====	=====	=====	=====	
Basic weighted average number of shares outstanding		14,621	14,252	14,538	14,202
		=====	=====	=====	=====
Diluted weighted average number of shares outstanding		14,933	14,543	14,873	14,349
		=====	=====	=====	=====

</TABLE>

The accompanying notes are an integral part
of these financial statements

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PDI, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

<TABLE>
<CAPTION>

	Nine Months Ended September 30,	
	2004	2003
	-----	-----
	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 16,485	\$ 7,772
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,272	4,428
Reserve for inventory obsolescence and bad debt	54	2,041
Loss on disposal of assets	264	--
Deferred taxes, net	7,660	--
Stock compensation costs	1,135	403
Other changes in assets and liabilities:		
Decrease in accounts receivable	19,665	1,823
Decrease (increase) in inventory	43	(363)
Decrease (increase) in unbilled costs	1,599	(1,106)
(Increase) in deferred training	(13)	(596)
(Increase) decrease in other current assets	(457)	15,807
Decrease in other long-term assets	68	140
(Decrease) in accounts payable	(5,779)	(209)
(Decrease) in accrued returns	(18,208)	(5,733)
(Decrease) increase in accrued liabilities	(3,471)	7,760
(Decrease) in restructuring liability	(423)	(4,225)
Increase (decrease) in unearned contract revenue	3,392	(800)
(Increase) decrease in income taxes and other accrued expenses ...	(1,593)	1,473

Net cash provided by operating activities	24,693	28,615
CASH FLOWS FROM INVESTING ACTIVITIES		
(Purchases) sales of short-term investments	(27,665)	4,279
Cash paid for acquisition, including closing costs	(28,394)	--
Purchase of property and equipment	(7,774)	(1,482)
Net cash (used in) provided by investing activities	(63,833)	2,797
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from exercise of stock options	3,136	886
Net cash provided by financing activities	3,136	886
Net (decrease) increase in cash and cash equivalents	(36,004)	32,298
Cash and cash equivalents - beginning	113,288	66,827
Cash and cash equivalents - ending	\$ 77,284	\$ 99,125

</TABLE>

The accompanying notes are an integral part
of these financial statements

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements of PDI, Inc. and its subsidiaries (the "Company" or "PDI") and related notes as included in the Company's Amended Annual Report on Form 10-K/A for the year ended December 31, 2003 as filed with the Securities and Exchange Commission. The unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial reporting and 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. The unaudited interim consolidated financial statements include all adjustments (consisting of normal recurring adjustments) which, in the judgment of management, are necessary for a fair presentation of such financial statements. Operating results for the three month and nine month periods ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. Certain prior period amounts have been reclassified to conform with the current presentation with no effect on financial position, net income or cash flows.

1B. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

We have restated our previously issued consolidated financial statements for the three and nine months ended September 30, 2003 (the previously issued financial statements) to apply the provisions of EITF 01-14, "Income Statement Characterization of Reimbursement Received for 'Out-of-Pocket' Expenses Incurred". (EITF 01-14) In September 2004, the Company became aware that it should have been applying EITF 01-04 to the previously issued financial statements. In accordance with EITF 01-14, direct reimbursements received by us from our clients for certain costs incurred should have been included as part of revenue with an identical increase to cost of goods and services, rather than being netted against cost of goods and services. Revenue and cost of goods and services in the previously issued financial statements were increased by \$8.3 million for the quarter ended September 30, 2003, and \$20.2 million for the nine months ended September 30, 2003. EITF 01-14, which was issued in late 2001, was

applicable for years beginning in 2002, and also required reclassification of all previous periods for comparative purposes.

This restatement does not affect previously reported gross profit, operating income, net income, cash flows from operations or earnings per share. Additionally, there is no effect on the consolidated balance sheets, consolidated statements of cash flows or consolidated statements of stockholders' equity for the previously issued financial statements. A summary of the effects of the restatement to reclassify these amounts is as follows:

	QUARTER ENDED 30-SEP-03		NINE MONTHS ENDED 30-SEP-03	
	AS PREVIOUSLY REPORTED	AS RESTATED	AS PREVIOUSLY REPORTED	AS RESTATED
CONSOLIDATED STATEMENTS OF OPERATIONS:				
Service revenue	\$86,200	\$94,470	\$224,888	\$245,112
Product revenue	81	81	197	197
TOTAL REVENUE	86,281	94,551	225,085	245,309
Program expenses	61,815	70,085	162,004	182,228
Cost of goods sold	952	952	1,097	1,097
TOTAL COST OF GOODS AND SERVICES	62,767	71,037	163,101	183,325
GROSS PROFIT	\$23,514	\$23,514	\$ 61,984	\$ 61,984

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

2. REVENUE RECOGNITION

The paragraphs that follow describe the guidelines that the Company adheres to in accordance with GAAP when recognizing revenue and cost of goods and services in financial statements. In accordance with GAAP, service revenue and product revenue and their respective direct costs have been shown separately on the consolidated statements of operations.

Historically, the Company has derived a significant portion of its service revenue from a limited number of clients. Concentration of business in the pharmaceutical services industry is common and the industry continues to consolidate. As a result, the Company is likely to continue to experience significant client concentration in future periods. For the three months ended September 30, 2004, and 2003 the Company's three largest clients who each individually represented 10% or more of its service revenue, accounted for approximately, in the aggregate, 74.4%, and 72.4%, respectively, of the Company's service revenue. For the nine months ended September 30, 2004, and 2003 the Company's two largest clients who each accounted for 10% or more of its service revenue totaled, in the aggregate, 64.9%, and 67.0%, respectively, of the Company's service revenue.

Service Revenue and Program Expenses

Service revenue is earned primarily by performing product detailing programs and other marketing and promotional services under contracts. Revenue is recognized as the services are performed and the right to receive payment for the services is assured. Revenue is recognized net of any potential penalties until the performance criteria relating to the penalties have been achieved. Performance incentives, as well as termination payments, are recognized as revenue in the period earned and when payment of the bonus, incentive or other payment is assured. Under performance based contracts, revenue is recognized

when the performance based parameters are achieved.

Program expenses consist primarily of the costs associated with executing product detailing programs, performance based contracts or other sales and marketing services identified in the contract. Program expenses include personnel costs and other costs associated with executing a product detailing or other marketing or promotional program, as well as the initial direct costs associated with staffing a product detailing program. Such costs include, but are not limited to, facility rental fees, honoraria and travel expenses, sample expenses and other promotional expenses. Personnel costs, which constitute the largest portion of program expenses, include all labor related costs, such as salaries, bonuses, fringe benefits and payroll taxes for the sales representatives and sales managers and professional staff who are directly responsible for executing a particular program. Initial direct program costs are those costs associated with initiating a product detailing program, such as recruiting, hiring, and training the sales representatives who staff a particular product detailing program. All personnel costs and initial direct program costs, other than training costs, are expensed as incurred for service offerings. Product detailing, marketing and promotional expenses related to the detailing of products the Company distributes are recorded as a selling expense and are included in other selling, general and administrative expenses in the consolidated statements of operations.

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

Reimbursable Out-of-pocket Expenses

Reimbursable out-of-pocket expenses include those relating to out-of-pocket expenses and other similar costs, for which we are reimbursed at cost from our clients. In accordance with EITF 01-14 reimbursements received for out-of-pocket expenses incurred are characterized as revenue and an identical amount is included as cost of goods and services in the consolidated statements of operations. Out-of-pocket expenses for the three and nine month periods ended September 30, 2004 were \$5.4 million and \$18.0 million, respectively. Out-of-pocket expenses for the three and nine month periods ended September 30, 2003 were \$8.3 million and \$20.2 million, respectively.

Training and Other Initial Direct Costs

Training costs include the costs of training the sales representatives and managers on a particular product detailing program so that they are qualified to properly perform the services specified in the related contract. For all contracts, training costs are deferred and amortized on a straight-line basis over the shorter of the life of the contract to which they relate or 12 months. When the Company receives a specific contract payment from a client upon commencement of a product detailing program expressly to compensate the Company for recruiting, hiring and training services associated with staffing that program, such payment is deferred and recognized as revenue in the same period that the recruiting and hiring expenses are incurred and amortization of the deferred training is expensed. When the Company does not receive a specific contract payment for training, all revenue is deferred and recognized over the life of the contract.

Product Revenue and Cost of Goods Sold

Product revenue is recognized when products are shipped and title is transferred to the customer. Product revenue for the three and nine month periods ended September 30, 2004 was negative, primarily from the adjustment to the Cefitin returns reserve, as discussed in Note 5 to the consolidated financial statements, net of the sale of the Xylos wound care products. Product revenue of \$81,000 and \$197,000 for the three and nine month periods ended September 30, 2003 was primarily from the sale of the Xylos wound care products.

Cost of goods sold includes all expenses for product distribution costs,

acquisition and manufacturing costs of the product sold.

3. ACQUISITION

On August 31, 2004, the Company acquired substantially all of the assets of Pharmakon, L.L.C. ("Pharmakon") in a transaction treated as an asset acquisition for tax purposes. The acquisition has been accounted for as a purchase, subject to the provisions of Statement of Financial Accounting Standards (SFAS) 141. The Company made payments to the members of Pharmakon at closing of \$27.4 million, and assumed approximately \$2.6 million in net liabilities. Additional payments of approximately \$1.0 million were made as a result of closing costs. Additionally, the members of Pharmakon can still earn up to an additional \$10 million in cash based upon achievement of certain annual profit targets through December 2006. These payments, if made, would be added to goodwill. In connection with this transaction, the Company has recorded \$29.5 million in goodwill and other identifiable intangibles, which consists of \$10.6 million in goodwill and \$18.9 million in other identifiable intangible assets.

Pharmakon is a healthcare communications company focused on the marketing of ethical pharmaceutical and biotechnology products. A primary reason for the acquisition of Pharmakon was the advancement of the Company's goal to expand its presence in the growing and heavily outsourced medical education market. Pharmakon's emphasis is on the creation, design and implementation of interactive peer persuasion programs. The successful integration of Pharmakon and PDI will result in both companies leveraging their account relationships and successfully cross selling their services.

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

The following unaudited pro forma consolidated results of operations for the nine-month periods ended September 30, 2004 and 2003 assume that the Company and Pharmakon had been combined as of the beginning of the periods presented. The pro forma results include estimates and assumptions which management believes are reasonable. However, pro forma results are not necessarily indicative of the results that would have occurred if the acquisition had been consummated as of the dates indicated, nor are they necessarily indicative of future operating results.

	Nine Months Ended September 30,	
	2004	2003
	-----	-----
	(in thousands, except for per share data)	
Revenue	\$ 289,765	\$ 256,761
Net income	\$ 18,622	\$ 9,174
Earnings per share	\$ 1.25	\$ 0.64

4. STOCK-BASED COMPENSATION

In June 2004, the Company adopted the PDI, Inc. 2004 Stock Award and Incentive Plan (the 2004 Plan), which was approved by the Company's board of directors in March 2004 and approved by the Company's Stockholders in June 2004. The 2004 Plan supplements the Company's 2000 Omnibus Incentive Compensation Plan and 1998 Stock Option Plan (the Preexisting Plans), reserving 2,896,868 shares for options, restricted stock and a variety of other types of awards. The 2004 Plan authorizes a broad range of awards, including stock options, stock appreciation rights, restricted stock, deferred stock, other awards based on common stock, dividend equivalents, stock-based performance awards, cash-based performance awards, shares issuable in lieu of rights to cash compensation and discounted options pursuant to an employee stock purchase program. No new awards will be authorized for grant under the Preexisting Plans, but previously

authorized awards under those plans will remain in effect. SFAS No. 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION" allows companies a choice of measuring employee stock-based compensation expense based on either the fair value method of accounting or the intrinsic value approach under the Accounting Pronouncement Board (APB) Opinion No. 25. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, AND RELATED INTERPRETATIONS." No stock option-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. Certain employees have received restricted common stock, the amortization of which is reflected in net income and was \$291,000 and \$856,000 for the three and nine month periods ended September 30, 2004. Additionally, during the first quarter of 2004, the Company accelerated the vesting of stock option grants and restricted stock grants for certain employees which resulted in total compensation of approximately \$275,000 in the quarter ended March 31, 2004. As required by SFAS No. 148, "ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE - AN AMENDMENT OF SFAS NO. 123", the following table shows the estimated effect on earnings and per share data as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003

	(in thousands, except per share data)			
	<C>	<C>	<C>	<C>
Net income, as reported	\$ 5,467	\$ 4,182	\$ 16,485	\$ 7,772
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	172	82	667	294
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(988)	(1,666)	(3,053)	(4,800)
	-----	-----	-----	-----
Pro forma net income	\$ 4,651	\$ 2,598	\$ 14,099	\$ 3,266
Net income per share				
Basic--as reported	\$ 0.37	\$ 0.29	\$ 1.13	\$ 0.55
Basic--pro forma	\$ 0.32	\$ 0.18	\$ 0.97	\$ 0.23
Diluted--as reported	\$ 0.37	\$ 0.29	\$ 1.11	\$ 0.54
Diluted--pro forma	\$ 0.31	\$ 0.18	\$ 0.95	\$ 0.23

</TABLE>

Compensation cost for the determination of pro forma net income - as adjusted and related per share amounts were estimated using the Black Scholes option pricing model, with the following assumptions: (i) risk free interest rate of 3.40% and 2.85% at September 30, 2004 and 2003, respectively; (ii) expected life of five years for the three and nine month periods ended September 30, 2004 and 2003; (iii) expected dividends - \$0 for the three and nine month periods ended September 30, 2004 and 2003; and (iv) volatility of 100% for the three and nine months periods ended September 30, 2004 and 2003. The weighted average fair value of options granted during the three and nine month periods ended September 30, 2004 was \$20.99 and \$19.27, respectively and for the three and nine month periods ended September 30, 2003 were \$12.94 and \$11.23, respectively.

In March 2003, the Company initiated an option exchange program pursuant to which eligible employees, which excluded certain members of senior management, were offered an opportunity to exchange an aggregate of 357,885 outstanding stock options with exercise prices of \$30.00 and above for either cash or shares of restricted stock, depending upon the number of options held by an eligible employee. The offer exchange period expired on May 12, 2003. Approximately 310,403 shares of common stock underlying eligible options were tendered by eligible employees and accepted by the Company. This number represented approximately 87% of the total shares of common stock underlying eligible options. A total of approximately 120 eligible participants elected to exchange an aggregate of approximately 59,870 shares of common stock under eligible options and received cash in the aggregate amount of approximately \$67,000 (which amount includes applicable withholding taxes). A total of approximately 145 eligible participants elected to exchange an aggregate of approximately 250,533 shares of common stock underlying eligible options in exchange for an aggregate of approximately 49,850 shares of restricted stock. All tendered options were canceled and became eligible for re-issuance under the Company's option plans. The restricted stock is subject to three-year cliff vesting and is subject to forfeiture upon termination of employment other than in the event of the recipient's death or disability.

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

Approximately 47,483 options, which were offered to, but did not participate in, the option exchange program, are subject to variable accounting. As such, the Company may record compensation expense if the market price of the Company's common stock exceeds the exercise price of the non-tendered options until these options are terminated, exercised or forfeited. To date, this has not occurred. The non-tendered options have exercise prices ranging from \$59.50 to \$80.00 and a remaining life of 6.0 to 6.3 years.

5. CEFTIN CONTRACT TERMINATION

In October 2000, the Company entered into an agreement (the Ceftin Agreement) with GlaxoSmithKline (GSK) for the exclusive U.S. sales, marketing and distribution rights for Ceftin(R) Tablets and Ceftin(R) for Oral Suspension, two dosage forms of a cephalosporin antibiotic, which agreement was terminated in February 2002 by mutual agreement of the parties. The Ceftin Agreement had a five-year term but was cancelable by either party without cause on 120 days' notice. From October 2000 through February 2002, the Company marketed Ceftin to physicians and sold the products primarily to wholesale drug distributors, retail chains and managed care providers.

On August 21, 2001, the U.S. Court of Appeals overturned a preliminary injunction granted by the New Jersey District Court to GSK, which subsequently allowed for the entry of a generic competitor to Ceftin immediately upon approval by the FDA. The affected Ceftin patent had previously been scheduled to run through July 2003. The generic version of Ceftin was approved by the FDA in February 2002 and it began to be manufactured in late March 2002. As a result of this U.S. Court of Appeals decision and its impact on future sales, in the third quarter of 2001 the Company recorded a charge to cost of goods sold and a related reserve of \$24.0 million representing the anticipated future loss to be incurred by the Company under the Ceftin Agreement as of September 30, 2001. The recorded loss was calculated as the excess of estimated costs that the Company was contractually obligated to incur to complete its obligations under the Ceftin Agreement, over the remaining estimated gross profits to be earned under the Ceftin Agreement from selling the inventory. These costs primarily consisted of amounts paid to GSK to reduce purchase commitments, estimated committed sales force expenses, selling and marketing costs through the effective date of the termination, distribution costs, and fees to terminate existing arrangements. The Ceftin Agreement was terminated by the Company and GSK under a mutual termination agreement entered into in December 2001. GSK resumed exclusive rights to Ceftin after the effective date of the termination of the Ceftin Agreement, and the Company believes that GSK currently sells Ceftin under its own label code.

Pursuant to the termination agreement, the Company agreed to perform marketing and distribution services through February 28, 2002. As is common in the pharmaceutical industry, customers who purchased the Company's Ceftin product are permitted to return unused product, after approval from the Company, up to six months before and one year after the expiration date for the product, but no later than December 31, 2004. The products sold by the Company prior to the Ceftin Agreement termination date of February 28, 2002 have expiration dates through June 2004. The Company also maintains responsibility for processing and payment of certain sales rebates through December 31, 2004. The Company's Ceftin sales aggregated approximately \$628 million during the term of the Ceftin Agreement.

As of December 31, 2002, the Company had accrued reserves of approximately \$16.5 million related to Ceftin sales. Of this accrual, \$11.0 million related to return reserves and \$5.5 million related to sales rebates accruals. On an ongoing basis, the Company assesses its reserve for product returns by: analyzing historical sales and return patterns; monitoring prescription data for branded Ceftin; monitoring inventory withdrawals by the wholesalers and retailers for branded Ceftin; inquiring about inventory levels and potential product returns with the wholesaler companies; and estimating demand for the product. During the third quarter of 2003, the Company made a \$5.5 million payment to settle its estimated remaining sales

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

rebate liabilities, and concluded based on its returns reserve review process, which included a review of prescription and withdrawal data for branded Ceftin as well as information communicated to the Company by the wholesalers, that the remaining \$11.0 million reserve for returns was adequate as of September 30, 2003.

In the fourth quarter of 2003, the Company determined, based primarily upon new information obtained from its wholesalers as part of its ongoing reserve review process, that significant amounts of inventory, incremental to that previously reported by the wholesalers, were being held by them in inventory. The Company believed that this resulted, in part, from the sale by the wholesalers of Ceftin product not supplied by the Company and acquired by the wholesalers subsequent to the mutual termination of the Ceftin agreement. Based upon that information, the Company increased its returns reserve \$12.0 million to a total reserve of \$22.8 million in the fourth quarter of 2003.

On March 31, 2004, the Company signed an agreement and waiver with a large wholesaler by which the Company agreed to pay that wholesaler \$10.0 million, and purchase \$2.5 million worth of services from that wholesaler by March 31, 2006, in exchange for that wholesaler waiving, to the fullest extent permitted by law, all rights with respect to any additional returns of Ceftin to the Company. The Company made the payment on April 5, 2004. In the second quarter of 2004 the Company increased its return reserve by approximately \$1.2 million based primarily upon new information obtained from the wholesalers as part of the Company's ongoing reserve review process.

The Company's reserve of \$4.6 million at September 30, 2004 reflects the Company's estimated liability for all identified product that could potentially be returned by all the remaining wholesalers, and an estimate of the Company's liability with respect to remaining, but not yet identified, product sold by the Company that is still being held in the trade. The reserve has been calculated based on, with respect to certain wholesalers, reimbursing the wholesalers at the amount that they purchased the product from the Company. The reserve as recorded by the Company is its best estimate based on its understanding of its obligations. The reserve also includes a liability of \$2.5 million for services to be purchased by the Company from a large wholesaler which the Company was able to negotiate in lieu of cash payments as described above. The Company will continue to assess the adequacy of its reserves until the Company's obligations for processing any returned products ceases on December 31, 2004.

6. OTHER PERFORMANCE BASED CONTRACTS

In May 2001, the Company entered into a copromotion agreement with Novartis Pharmaceuticals Corporation (Novartis) for the U.S. sales, marketing and promotion rights for Lotensin(R), Lotensin HCT(R) and Lotrel(R). That agreement was scheduled to run through December 31, 2003. On May 20, 2002, this agreement was replaced by two separate agreements, one for Lotensin and one for Lotrel-Diovan through the addition of Diovan(R) and Diovan HCT(R). Both of these agreements were scheduled to end December 31, 2003; however, the Lotrel-Diovan agreement was renewed on December 24, 2003 for an additional one year period. In February 2004, the Company was notified by Novartis of its intent to terminate the Lotrel-Diovan agreement, without cause, effective March 16, 2004 and, as a result, \$28.9 million of anticipated revenue associated with the Lotrel-Diovan agreement in 2004 will not be realized. The Company was compensated under the terms of the agreement through the effective termination date. Even though the Lotensin agreement ended December 31, 2003, the Company is still entitled to receive royalty payments on the sales of Lotensin through December 31, 2004. The royalties earned under this arrangement for the three and nine month periods ended September 30, 2004 were approximately \$441,000 and \$3.4 million, respectively; the royalties earned during the remainder of 2004 are expected to diminish because the product lost its patent protection in February 2004.

In October 2002, the Company entered into an agreement with Xylos Corporation (Xylos) for the

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exclusive U.S. commercialization rights to the Xylos XCell(TM) Cellulose Wound Dressing (XCell) wound care products. The Company began selling the Xylos products in January 2003; however, sales were significantly slower than anticipated and actual 2003 sales did not meet the Company's forecasts. The Company did have the right to terminate the agreement with 135 days' notice to Xylos, beginning January 1, 2004. Based on these sales results, the Company concluded that sales of XCell were not sufficient enough to sustain the Company's continued role as commercialization partner for the product and therefore, on January 2, 2004, the Company exercised its contractual right to terminate the agreement on 135 days' notice to Xylos. The Company accepted orders for XCell products through May 16, 2004 when the agreement terminated; however, the Company's promotional activities in support of the brand concluded in January 2004. The Company recorded a reserve for potential excess inventory during 2003 of approximately \$835,000. As discussed in Note 7, the Company continues to have an investment in Xylos. In addition, in February 2004, the Company entered into a term loan agreement with Xylos, pursuant to which it made loans to Xylos in an aggregate amount of \$500,000; \$375,000 was disbursed in the quarter ended March 31, 2004 and the remaining \$125,000 was disbursed in April 2004. Pursuant to the terms of the agreement, the loans are due to be repaid on June 30, 2005.

On December 31, 2002, the Company entered into a licensing agreement with Cellegy Pharmaceuticals, Inc. (Cellegy) for the exclusive North American rights for Fortigel(TM), a testosterone gel product. The agreement is in effect for the commercial life of the product. Cellegy submitted a New Drug Application (NDA) for the hypogonadism indication to the U.S. Food and Drug Administration (FDA) in June 2002. In July 2003, Cellegy received a letter from the FDA rejecting its NDA for Fortigel. Cellegy has told the Company that it is in discussions with the FDA to determine the appropriate course of action needed to meet deficiencies cited by the FDA in its determination. Under the terms of the agreement, the Company paid Cellegy a \$15.0 million initial licensing fee on December 31, 2002. Under the terms of the licensing agreement, if it should be enforced (see discussion of the lawsuit below), this nonrefundable payment was made prior to FDA approval and, since there is no alternative future use of the licensed rights, the \$15.0 million payment was expensed by the Company in December 2002, when incurred. This amount was recorded in other selling, general, and administrative expenses in the December 31, 2002 consolidated statements of operations. Pursuant to the terms of the licensing agreement, if it should be enforced (see discussion of lawsuit below), the Company will be required to pay Cellegy a \$10.0 million incremental license fee milestone payment upon Fortigel's receipt of all approvals required by the FDA (if such approvals are obtained) to promote, sell and distribute the product in the U.S.

This incremental milestone license fee, if incurred, will be recorded as an intangible asset and amortized over its estimated useful life, as then determined, which is not expected to exceed the life of the patent. The Company believes that it will not be required to pay Cellegy the \$10.0 million incremental license fee milestone payment in 2004, and it is unclear at this point when or if Cellegy will get Fortigel approved by the FDA which would trigger the Company's obligation to pay \$10.0 million to Cellegy. Royalty payments to Cellegy over the term of the commercial life of the product would range from 20% to 30% of net sales. As discussed in Note 13, the Company filed a complaint against Cellegy in December 2003, that alleges, among other things, that Cellegy fraudulently induced the Company to enter into the licensing agreement, and seeks the return of the \$15.0 million initial licensing fee, plus additional damages caused by Cellegy's conduct. Since the Company filed the lawsuit, Cellegy is no longer in regular contact with the Company regarding Fortigel. Thus, for example, the Company has been informed that Cellegy is in continuing contact with the FDA but the Company is unaware of the precise FDA status regarding Fortigel (as of June 30, 2004, it had not been approved). Accordingly, the Company may not possess the most current and reliable information concerning the current status of, or future prospects relating to Fortigel. The issuance of the non-approvable letter by the FDA concerning Fortigel, however, casts significant doubt upon Fortigel's prospects and whether it will ever be approved. The Company cannot predict with any certainty whether the FDA will ultimately approve Fortigel for sale in the U.S.

As discussed in Note 13, in May 2003, the Company settled a lawsuit with Auxilium

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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Pharmaceuticals, Inc. which sought to enjoin its performance under the Cellegy agreement.

7. OTHER INVESTMENTS

In October 2002, the Company acquired \$1.0 million of preferred stock of Xylos. The Company recorded its investment in Xylos under the cost method and its ownership interest in Xylos is less than five percent. As discussed in Note 6, the Company served in 2003 as the exclusive distributor of the Xylos XCell product line, but on January 2, 2004, the Company terminated that arrangement effective May 16, 2004. In addition, in February 2004, the Company entered into a term loan agreement with Xylos, pursuant to which it has made loans to Xylos in an aggregate amount of \$500,000; \$375,000 was disbursed in the quarter ended March 31, 2004 and the remaining \$125,000 was disbursed in April 2004. Pursuant to the terms of the agreement, the loans are due to be repaid on June 30, 2005. Although Xylos recognized operating losses in 2003 and through the first nine months of 2004, the Company continues to believe that, based on current prospects and activities at Xylos, its investment in Xylos is not impaired and the amounts loaned are recoverable as of September 30, 2004. However, if Xylos continues to experience losses and is not able to generate sufficient cash flows through financing, the Company may not recover its loans and its investment may become impaired.

In May 2004, the Company entered into a loan agreement with TMX Interactive, Inc. (TMX), a provider of sales force effectiveness technology. Pursuant to the loan agreement, the Company provided TMX with a term loan facility of \$500,000 and a convertible loan facility of \$500,000, each of which are due to be repaid on November 26, 2005. In connection with the convertible loan facility, the Company has the right to convert all, or, in multiples of \$100,000, any part of the convertible note into common stock of TMX.

8. INVENTORY

At September 30, 2004 the Company no longer has any finished goods inventory relating to the XCell wound care products. At December 31, 2003, the Company had approximately \$43,000 in finished goods inventory, net of reserves.

In the third quarter of 2003, as a result of the continued lower than

anticipated Xylos product sales, management recorded a reserve of \$835,000 to reduce the value of the XCell inventory to its estimated net realizable value. As discussed in Note 6, on January 2, 2004 the Company gave notice of termination of its agreement with Xylos, effective May 16, 2004. As of September 30, 2004 all remaining inventory had been destroyed.

9. NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Interpretation No. 46, "CONSOLIDATION OF VARIABLE INTEREST ENTITIES" (FIN 46). FIN 46 requires a variable interest entity (VIE) to be consolidated by a company, if that company is subject to a majority of the risk of loss from the VIE's activities or entitled to receive a majority of the entity's residual returns or both. In December 2003, the FASB issued a revision to the FIN 46 (FIN46R) which partially delayed the effective date of the interpretation to March 31, 2004 and added additional scope exceptions. The adoption of FIN46 and FIN46R did not have a material impact on the Company's business, financial condition and results of operations.

In December 2003, the Staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 (SAB 104), "REVENUE RECOGNITION," which supercedes SAB 101, "REVENUE RECOGNITION

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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IN FINANCIAL STATEMENTS." SAB 104's primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF 00-21, "ACCOUNTING FOR REVENUE ARRANGEMENTS WITH MULTIPLE DELIVERABLES." Additionally, SAB 104 rescinds the SEC's "REVENUE RECOGNITION IN FINANCIAL STATEMENTS FREQUENTLY ASKED QUESTIONS AND ANSWERS" (the FAQ) issued with SAB 101 that had been codified in SEC Topic 13, "REVENUE RECOGNITION." The revenue recognition principles provided for in both SAB 101 and EITF 00-21 remain largely unchanged. As a result, the adoption of SAB 104 did not have a material impact on the Company's business, financial condition and results of operations.

On March 31, 2004, the FASB issued an Exposure Draft, "Share-Based Payment - - An Amendment of FASB Statements No. 123 and 95" (proposed FAS 123R), which currently is expected to be effective for public companies in periods beginning after June 15, 2005. We would be required to implement the proposed standard no later than the quarter that begins July 1, 2005. The cumulative effect of adoption, if any, applied on a modified prospective basis, would be measured and recognized on July 1, 2005. The proposed FAS 123R addresses the accounting for transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed FAS 123R would eliminate the ability to account for share-based compensation transactions using APB 25, and generally would require instead that such transactions be accounted for using a fair-value based method. As proposed, companies would be required to recognize an expense for compensation cost related to share-based payment arrangements including stock options and employee stock purchase plans. The FASB expects to issue a final standard by December 31, 2004. We are currently evaluating option valuation methodologies and assumptions in light of the proposed FAS 123R related to employee stock options. Current estimates of option values using the Black-Scholes method (as shown above) may not be indicative of results from valuation methodologies ultimately adopted in the final rules.

10. HISTORICAL AND PRO FORMA BASIC AND DILUTED NET INCOME PER SHARE

Historical and pro forma basic and diluted net income per share is calculated based on the requirements of SFAS No. 128, "EARNINGS PER SHARE." A reconciliation of the number of shares used in the calculation of basic and diluted earnings per share for the periods ended September 30, 2004 and 2003 is as follows:

Three Months Ended Nine Months Ended
September 30, September 30,

	2004	2003	2004	2003
--	------	------	------	------

(in thousands)

Basic weighted average number of common shares outstanding	14,621	14,252	14,538	14,202
Dilutive effect of stock options and restricted stock	312	291	335	147
Diluted weighted average number of common shares outstanding	14,933	14,543	14,873	14,349

Outstanding options at September 30, 2004 to purchase 412,268 shares of common stock with exercise prices ranging from \$27.00 to \$93.75 were not included in the computation of historical and pro forma diluted net income per share because to do so would have been antidilutive. Outstanding options at September 30, 2003 to purchase 447,174 shares of common stock with exercise prices ranging from

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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\$21.10 to \$93.75 were not included in the computation of historical and pro forma diluted net income per share because to do so would have been antidilutive.

11. SHORT-TERM INVESTMENTS

At September 30, 2004, short-term investments were \$29.0 million, including approximately \$1.5 million of investments classified as available for sale securities. At September 30, 2003, short-term investments were \$1.7 million, including approximately \$1.2 million of investments classified as available for sale securities. The unrealized after-tax gain/(loss) on the available for sale securities is included as a separate component of stockholders' equity as accumulated other comprehensive income. All other short-term investments are stated at cost, which approximates fair value.

12. OTHER COMPREHENSIVE INCOME

A reconciliation of net income as reported in the Consolidated Statements of Operations to Other comprehensive income, net of taxes is presented in the table below.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003

(thousands)

Net income	\$ 5,467	\$ 4,182	\$16,485	\$ 7,772
Other comprehensive income, net of tax:				
Unrealized holding gain on available-for-sale securities arising during the period	(10)	16	1	106
Reclassification adjustment for losses included in net income	--	3	21	37
Other comprehensive income	\$ 5,457	\$ 4,201	\$16,507	\$ 7,915

13. COMMITMENTS AND CONTINGENCIES

Due to the nature of the business in which the Company is engaged, such as product detailing and distribution of products, it could be exposed to certain

risks. Such risks include, among others, risk of liability for personal injury or death to persons using products the Company promotes or distributes. There can be no assurance that substantial claims or liabilities will not arise in the future because of the nature of the Company's business activities and recent increases in litigation related to healthcare products, including pharmaceuticals, increases this risk. The Company seeks to reduce its potential liability under its service agreements through measures such as contractual indemnification provisions with clients (the scope of which may vary from client to client, and the performances of which are not secured) and insurance. The Company could, however, also be held liable for errors and omissions of its employees in connection with the services it performs that are outside the scope of any indemnity or insurance policy. The Company could be materially adversely affected if it was required to pay damages or incur defense costs in connection with a claim that is outside the scope of an indemnification agreement; if the indemnity, although applicable, is not performed in accordance with its terms; or if the Company's liability exceeds the amount of applicable insurance or indemnity.

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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SECURITIES LITIGATION

In January and February 2002, the Company, its chief executive officer and its chief financial officer were served with three complaints that were filed in the United States District Court for the District of New Jersey alleging violations of the Securities Exchange Act of 1934 (the "Exchange Act"). These complaints were brought as purported shareholder class actions under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 established thereunder. On May 23, 2002, the Court consolidated all three lawsuits into a single action entitled *In re PDI Securities Litigation*, Master File No. 02-CV-0211, and appointed lead plaintiffs (Lead Plaintiffs) and Lead Plaintiffs' counsel. On or about December 13, 2002, Lead Plaintiffs filed a second consolidated and amended complaint (Second Consolidated and Amended Complaint), which superseded their earlier complaints.

The complaint names the Company, its chief executive officer and its chief financial officer as defendants; purports to state claims against the Company on behalf of all persons who purchased the Company's Common Stock between May 22, 2001 and August 12, 2002; and seeks money damages in unspecified amounts and litigation expenses including attorneys' and experts' fees. The essence of the allegations in the Second Consolidated and Amended Complaint is that the Company intentionally or recklessly made false or misleading public statements and omissions concerning its financial condition and prospects with respect to its marketing of Cefitin in connection with the October 2000 distribution agreement with GSK, its marketing of Lotensin in connection with the May 2001 distribution agreement with Novartis, as well as its marketing of Evista(R) in connection with the October 2001 distribution agreement with Eli Lilly and Company.

In February 2003, the Company filed a motion to dismiss the Second Consolidated and Amended Complaint under the Private Securities Litigation Reform Act of 1995 and Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. That motion is fully submitted to the court for its decision. The Company believes that the allegations in this purported securities class action are without merit and intends to defend the action vigorously.

BAYER-BAYCOL LITIGATION

The Company has been named as a defendant in numerous lawsuits, including two class action matters, alleging claims arising from the use of Baycol(R), a prescription cholesterol-lowering medication. Baycol was distributed, promoted and sold by Bayer Corporation (Bayer) in the United States through early August 2001, at which time Bayer voluntarily withdrew Baycol from the United States market. Bayer retained certain companies, such as the Company, to provide detailing services on its behalf pursuant to contract sales force agreements. The Company may be named in additional similar lawsuits. To date, the Company has defended these actions vigorously and has asserted a contractual right of indemnification against Bayer for all costs and expenses the Company incurs

relating to these proceedings. In February 2003, the Company entered into a joint defense and indemnification agreement with Bayer, pursuant to which Bayer has agreed to assume substantially all of the Company's defense costs in pending and prospective proceedings and to indemnify the Company in these lawsuits, subject to certain limited exceptions. Further, Bayer agreed to reimburse the Company for all reasonable costs and expenses incurred to date in defending these proceedings. To date, Bayer has reimbursed the Company for approximately \$1.6 million in legal expenses, of which approximately \$700,000 was received in the nine months ended September 30, 2003 and was reflected as a credit within selling, general and administrative expense. No amounts have been recorded in 2004.

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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AUXILIUM PHARMACEUTICALS LITIGATION

On January 6, 2003, the Company was named as a defendant in a lawsuit filed by Auxilium Pharmaceuticals, Inc. (Auxilium), in the Pennsylvania Court of Common Pleas, Montgomery County. Auxilium was seeking monetary damages and injunctive relief, including preliminary injunctive relief, based on several claims related to the Company's alleged breaches of a contract sales force agreement entered into by the parties on November 20, 2002, and claims that the Company was misappropriating trade secrets in connection with its exclusive license agreement with Cellegy.

On May 8, 2003, the Company entered into a settlement and mutual release agreement with Auxilium (Settlement Agreement), by which the lawsuit and all related counter claims were dropped without any admission of wrongdoing by either party. The settlement terms included a cash payment which was paid upon execution of the Settlement Agreement as well as certain other additional expenses. The Company recorded a \$2.1 million charge in the first quarter of 2003 related to this settlement. Pursuant to the Settlement Agreement, the Company also agreed that it would (a) not sell, ship, distribute or transfer any Fortigel product to any wholesalers, chain drug stores, pharmacies or hospitals prior to November 1, 2003, and (b) pay Auxilium an additional amount per prescription to be determined based upon a specified formula, in the event any prescriptions were filled for Fortigel prior to January 26, 2004. As discussed in Note 6, in July 2003, Cellegy received a letter from the FDA rejecting its NDA for Fortigel. The Company did not pay any additional amount to Auxilium as set forth in clause (b) above since Fortigel was not approved by the FDA prior to January 26, 2004. The Company does not believe that the terms of the Settlement Agreement will have any impact on the success of its commercialization of the product if, or when, the FDA approves it.

CELLEGY PHARMACEUTICALS LITIGATION

On December 12, 2003, the Company filed a complaint against Cellegy in the U.S. District Court for the Southern District of New York. The complaint alleges that Cellegy fraudulently induced the Company to enter into a December 2002 license agreement with Cellegy regarding Fortigel ("License Agreement"). The complaint also alleges claims for misrepresentation and breach of contract related to the License Agreement. In the complaint, the Company seeks, among other things, rescission of the License Agreement and return of the \$15.0 million initial licensing fee it paid Cellegy. After the Company filed this lawsuit, also on December 12, 2003, Cellegy filed a complaint against the Company in the U.S. District Court for the Northern District of California. Cellegy's complaint seeks a declaration that Cellegy did not fraudulently induce the Company to enter the License Agreement and that Cellegy has not breached its obligations under the License Agreement. The Company filed an answer to Cellegy's complaint on June 18, 2004, in which it makes the same allegations and claims for relief as it does in its New York action, and it also alleges Cellegy violated California unfair competition law. By order dated April 23, 2004, the Company's lawsuit was transferred to the Northern District of California where it may be consolidated with Cellegy's action. The Company is unable to predict the ultimate outcome of these lawsuits.

OTHER LEGAL PROCEEDINGS

The Company is currently a party to other legal proceedings incidental to its business. While the Company currently believes that the ultimate outcome of these proceedings individually, and in the aggregate, will not have a material adverse effect on its consolidated financial statements, litigation is subject to inherent uncertainties. Were the Company to settle a proceeding for a material amount or were an unfavorable ruling to occur, there exists the possibility of a material adverse effect on the Company's business, financial condition and results of operations.

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No material amounts have been accrued for losses under any of the above mentioned matters, as no amounts are considered probable or reasonably estimable at this time.

Other than the foregoing, the Company is not currently a defendant in any material pending litigation and it is not aware of any material threatened litigation.

14. RESTRUCTURING AND OTHER RELATED EXPENSES

During the third quarter of 2002, the Company adopted a restructuring plan, the objective of which was to consolidate operations in order to enhance operating efficiencies (the 2002 Restructuring Plan). This plan was primarily in response to the general decrease in demand within the Company's markets for the sales and marketing services segment, and the recognition that the infrastructure that supported these business units was larger than required. The Company originally estimated that the restructuring would result in annualized SG&A savings of approximately \$14.0 million, based on the level of SG&A spending at the time it initiated the restructuring. However, these savings have been partially offset by incremental SG&A expenses the Company incurred in subsequent periods as the Company has been successful in expanding its business platforms. Substantially all of the restructuring activities were completed as of December 31, 2003.

During the quarter ended March 31, 2003, the Company recognized a \$270,000 reduction in the restructuring accrual due to negotiating higher sublease proceeds than originally estimated for the leased facility in Cincinnati, Ohio.

During the quarter ended June 30, 2003 the Company incurred approximately \$133,000 of additional restructuring expense due to higher than expected contractual termination costs. This additional expense was recorded in program expenses consistent with the original recording of the restructuring charges.

Also during the quarter ended June 30, 2003 the Company recognized a \$473,000 reduction in the restructuring accrual due to lower than expected sales force severance costs. Greater success in the reassignment of sales representatives to other programs and the voluntary departure of other sales representatives combined to reduce the requirement for severance costs. This adjustment was recorded in program expenses consistent with the original recording of the restructuring charges.

The accrual for restructuring and exit costs totaled approximately \$321,000 at September 30, 2004, and is recorded in current liabilities on the accompanying balance sheet.

A roll forward of the activity for the 2002 Restructuring Plan is as follows:

	BALANCE AT DECEMBER 31, (IN THOUSANDS)	2003	ADJUSTMENTS	BALANCE AT SEPTEMBER 30, PAYMENTS	2004
Administrative severance	\$285	\$ --	\$(199)	\$ 86	
Exit costs	459	--	(224)	235	
	744	--	(423)	321	

Sales force severance	--	--	--	--
TOTAL	\$744	\$ --	\$(423)	\$321

15. SEGMENT INFORMATION

Effective in the first quarter of 2004, the Company reorganized its internal operating units from three reporting segments into two reporting segments: sales and marketing services group (SMSG) and PDI

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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products group (PPG). These reorganized segments reflect the termination of the Xylos agreement and the decision to manage the other medical device and diagnostic (MD&D) units under the Company's existing contract sales structure. Additionally, the reorganized segments reflect the greater emphasis the Company intends to place on its services business and away from licensing and acquiring pharmaceutical and medical device products. As a result of this reorganization, the MD&D segment was disaggregated and assimilated into the two remaining segments. The MD&D segment was comprised of the clinical sales unit, MD&D contract sales unit, and product licensing. The SMSG segment now includes the Company's clinical sales and MD&D contract sales units; the Company's dedicated and shared contract sales units; and the Company's marketing research and medical education and communication services. The businesses within SMSG recognize revenue predominantly through fee for service contracts. The PPG contracts are characterized by either significant management effort required from the Company's product marketing group, or reliance on the attainment of performance incentives in order to fully cover the Company's costs, or both. The PPG segment now includes MD&D product offerings in addition to the rest of the Company's copromotion services. PPG derives revenue through a variety of agreement types including directly from product sales or based on a formula with product sales as its basis. The segment information from prior periods has been restated to conform to the current period's presentation.

Corporate charges are allocated to each of the operating segments on the basis of total salary costs. Corporate charges include corporate headquarter costs and certain depreciation expense. Capital expenditures have not been allocated to the operating segments since it is impracticable to do so.

<TABLE>
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	Three Months Ended September 30,		Nine Months Ended September 30,		
	2004	2003	2004	2003	
	(in thousands)				
	<C>	<C>	<C>	<C>	
Revenue (2003 amounts restated)					
Sales and marketing services group	\$ 92,008	\$ 81,322	\$274,131	\$209,631	
PDI products group	514	13,229	2,501	35,677	
Total	\$ 92,522	\$ 94,551	\$276,632	\$245,308	

Income (loss) from operations, before corporate allocations

Sales and marketing services group	\$ 16,825	\$ 12,087	\$ 50,483	\$ 32,999
PDI products group	200	(1,609)	(321)	(8,870)
Corporate charges	(7,990)	(3,937)	(23,082)	(11,983)
Total	\$ 9,035	\$ 6,541	\$ 27,080	\$ 12,146

Corporate allocations				
Sales and marketing services group	\$ (7,964)	\$ (3,438)	\$ (22,895)	\$ (10,113)
PDI products group	(26)	(499)	(187)	(1,870)
Corporate charges	7,990	3,937	23,082	11,983
	-----	-----	-----	-----
Total	\$ --	\$ --	\$ --	\$ --
	=====	=====	=====	=====

</TABLE>

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NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
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<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003

	(in thousands)			
	<C>	<C>	<C>	<C>
	-----	-----	-----	-----
Income (loss) from operations, less corporate allocations				
Sales and marketing services group	\$ 8,861	\$ 8,649	\$ 27,588	\$ 22,886
Pharmaceutical products group	174	(2,108)	(508)	(10,740)
Corporate charges	--	--	--	--
	-----	-----	-----	-----
Total	\$ 9,035	\$ 6,541	\$ 27,080	\$ 12,146
	=====	=====	=====	=====

Reconciliation of income from operations to
income before provision for income taxes

Total EBIT for operating groups	\$ 9,035	\$ 6,541	\$ 27,080	\$ 12,146
Other income, net	230	246	861	741
	-----	-----	-----	-----
Income before provision for income taxes	\$ 9,265	\$ 6,787	\$ 27,941	\$ 12,887
	=====	=====	=====	=====

Capital expenditures

Sales and marketing services group	\$ 2,772	\$ 1,055	\$ 7,774	\$ 1,482
PDI products group	--	--	--	--
	-----	-----	-----	-----
Total	\$ 2,772	\$ 1,055	\$ 7,774	\$ 1,482
	=====	=====	=====	=====

Depreciation expense

Sales and marketing services group	\$ 1,095	\$ 965	\$ 3,674	\$ 2,864
PDI products group	3	649	28	1,103
	-----	-----	-----	-----
Total	\$ 1,098	\$ 1,614	\$ 3,702	\$ 3,967
	=====	=====	=====	=====

</TABLE>

15. GOODWILL AND INTANGIBLE ASSETS

Effective January 1, 2002, the Company adopted SFAS No. 142, "GOODWILL AND OTHER INTANGIBLE ASSETS." Under SFAS No. 142, goodwill is no longer amortized but is evaluated for impairment on at least an annual basis. The Company has established reporting units for purposes of testing goodwill for impairment. Goodwill has been assigned to the reporting units to which the value of the goodwill relates. The Company performed the required annual impairment tests in the fourth quarter of 2003 and determined that no impairment existed at December 31, 2003. These tests involved determining the fair market value of each of the reporting units with which the goodwill was associated and comparing the estimated fair market value of each of the reporting units with its carrying amount. The Company's total goodwill, which is not subject to amortization, totaled \$21.8 million and \$11.1 million as of September 30, 2004 and December 31, 2003, respectively.

As a result of the acquisition of Pharmakon (discussed in Note 3), there was an additional \$10.6 million added to the carrying amount of goodwill. The carrying amounts at September 30, 2004 by operating segment are shown below:

(in thousands)	SMSG	PPG	TOTAL
	-----	-----	-----
Balance as of December 31, 2003	\$11,132	\$ --	\$11,132
Amortization	--	--	--
Acquisitions	10,627	--	10,627
	-----	-----	-----
Balance as of September 30, 2004	<u>\$21,759</u>	<u>\$ --</u>	<u>\$21,759</u>

All identifiable intangible assets recorded as of September 30, 2004 are being amortized on a straight-line basis over the life of the intangibles which range from 5 to 15 years. The carrying amounts at September 30, 2004 and December 31, 2003 are as follows:

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PDI, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS - CONTINUED
(UNAUDITED)

<TABLE>

<CAPTION>

(in thousands)	As of September 30, 2004			As of December 31, 2003		
	-----	-----	-----	-----	-----	-----
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Covenant not to compete	\$ 1,826	\$1,035	\$ 791	\$1,686	\$ 780	\$ 906
Customer relationships	17,508	831	16,677	1,208	559	649
Corporate tradename	2,672	119	2,553	172	79	93
	-----	-----	-----	-----	-----	-----
Total	<u>\$22,006</u>	<u>\$1,985</u>	<u>\$20,021</u>	<u>\$3,066</u>	<u>\$1,418</u>	<u>\$1,648</u>

</TABLE>

Amortization expense totaled approximately \$260,000 and \$567,000 for the three and nine months ended September 30, 2004 and approximately \$153,000 and \$460,000 for the three and nine months ended September 30, 2003. Estimated amortization expense for the next five years is as follows:

(in thousands)	
2004	<u>\$1,040</u>
2005	<u>1,895</u>
2006	<u>1,703</u>
2007	<u>1,281</u>
2008	<u>1,281</u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

VARIOUS STATEMENTS MADE IN THIS QUARTERLY REPORT ON FORM 10-Q ARE "FORWARD-LOOKING STATEMENTS" (WITHIN THE MEANING OF THE PRIVATE SECURITIES

LITIGATION REFORM ACT OF 1995) REGARDING THE PLANS AND OBJECTIVES OF MANAGEMENT FOR FUTURE OPERATIONS. THESE STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS THAT MAY CAUSE OUR ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY THESE FORWARD-LOOKING STATEMENTS. THE FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT ARE BASED ON CURRENT EXPECTATIONS THAT INVOLVE NUMEROUS RISKS AND UNCERTAINTIES. OUR PLANS AND OBJECTIVES ARE BASED, IN PART, ON ASSUMPTIONS INVOLVING JUDGEMENTS ABOUT, AMONG OTHER THINGS, FUTURE ECONOMIC, COMPETITIVE AND MARKET CONDITIONS AND FUTURE BUSINESS DECISIONS, ALL OF WHICH ARE DIFFICULT OR IMPOSSIBLE TO PREDICT ACCURATELY AND MANY OF WHICH ARE BEYOND OUR CONTROL. ALTHOUGH WE BELIEVE THAT OUR ASSUMPTIONS UNDERLYING THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, ANY OF THESE ASSUMPTIONS COULD PROVE INACCURATE AND, THEREFORE, WE CANNOT ASSURE YOU THAT THE FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT WILL PROVE TO BE ACCURATE. IN LIGHT OF THE SIGNIFICANT UNCERTAINTIES INHERENT IN THE FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT, THE INCLUSION OF THESE STATEMENTS SHOULD NOT BE INTERPRETED BY ANYONE THAT OUR OBJECTIVES AND PLANS WILL BE ACHIEVED. FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY AND ADVERSELY FROM THOSE EXPRESSED OR IMPLIED BY FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO, THE FACTORS, RISKS AND UNCERTAINTIES (i) IDENTIFIED OR DISCUSSED HEREIN, (ii) SET FORTH IN "RISK FACTORS" UNDER PART I, ITEM 1, OF THE COMPANY'S AMENDED ANNUAL REPORT ON FORM 10-K/A FOR THE YEAR ENDED DECEMBER 31, 2003 AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, AND (iii) SET FORTH IN THE COMPANY'S PERIODIC REPORTS ON FORMS 10-Q/A AND 8-K AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION SINCE JANUARY 1, 2004. WE UNDERTAKE NO OBLIGATION TO REVISE OR UPDATE PUBLICLY ANY FORWARD-LOOKING STATEMENTS FOR ANY REASON.

RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

We have restated our previously issued consolidated financial statements for the quarter ended September 30, 2003 (the previously issued financial statements) to apply the provisions of EITF 01-14, "Income Statement Characterization of Reimbursement Received for 'Out-of-Pocket' Expenses Incurred". In accordance with EITF 01-14, direct reimbursements received by us from our clients for certain costs incurred should have been included as part of revenue with an identical increase to cost of goods and services, rather than being netted against cost of goods and services. Revenue and cost of goods and services in the previously issued financial statements were increased by \$8.3 million for the quarter ended September 30, 2003, and \$20.2 million for the nine months ended September 30, 2003. EITF 01-14, which was issued in late 2001, was applicable for years beginning in 2002, and also required reclassification of all previous periods for comparative purposes.

This restatement does not affect previously reported gross profit, operating income, net income, cash flows from operations or earnings per share. Additionally, there is no effect on the consolidated balance sheets, consolidated statements of cash flows or consolidated statements of stockholders' equity for the previously issued financial statements. A summary of the effects of the restatement to reclassify these amounts is as follows:

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	QUARTER ENDED 30-SEP-03		NINE MONTHS ENDED 30-SEP-03	
	AS PREVIOUSLY REPORTED	AS RESTATED	PREVIOUSLY REPORTED	AS RESTATED
CONSOLIDATED STATEMENTS OF OPERATIONS:				
Service revenue	\$ 86,200	\$ 94,470	\$ 224,888	\$ 245,112
Product revenue	81	81	197	197
TOTAL REVENUE	86,281	94,551	225,085	245,309
Program expenses	61,815	70,085	162,004	182,228
Cost of goods sold	952	952	1,097	1,097
TOTAL COST OF GOODS AND SERVICES	62,767	71,037	163,101	183,325

-----	-----	-----	-----	
GROSS PROFIT	\$ 23,514	\$ 23,514	\$ 61,984	\$ 61,984
-----	-----	-----	-----	

OVERVIEW

We are a healthcare sales and marketing company serving the biopharmaceutical and medical devices and diagnostics (MD&D) industries. We create and execute sales and marketing campaigns intended to improve the profitability of pharmaceutical or MD&D products. We do this by partnering with companies who own the intellectual property rights to these products and recognize our ability to commercialize these products and maximize their sales performance. We have a variety of agreement types that we enter into with our partner companies, ranging from fee for service arrangements to performance based contracts.

REPORTING SEGMENTS

Our business is organized into two reporting segments:

- o PDI sales and marketing services group (SMSG), comprised of:
 - o Sales Teams Business
 - o Dedicated contract sales teams
 - o Shared contract sales teams
 - o Medical device and diagnostic contract sales teams
 - o Clinical sales teams
 - o Hybrid teams
 - o Marketing research and consulting (MR&C)
 - o Medical education and communications (PDI EdComm and Pharmakon)
- o PDI products group (PPG) is comprised of those agreements in which PDI is directly or indirectly compensated on the basis of product sales. This segment currently has the remaining revenue from PDI's agreement with Novartis in support of Lotensin and the agreement with Xylos in support of XCell wound care products. We terminated our agreement our agreement with Xylos effective May 16, 2004. Both agreements have been terminated and the PPG segment is reporting the residual financial activity from those agreements.

We reorganized our segments in the first quarter of 2004 due to the termination of the Xylos agreement and the decision to manage the other MD&D units under our existing contract sales structure. Additionally, the reorganized segments reflect the greater emphasis we intend to place on our services business and away from licensing and acquiring pharmaceutical and medical device products. The businesses within the sales and marketing services group recognize revenue predominantly through fee

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for service contracts. The products group derives revenue through a variety of agreement types including directly from product sales or based on a formula with product sales as its basis. The PPG contracts are characterized by either significant management effort required from our product marketing group, or reliance on the attainment of performance incentives in order to fully cover our costs, or both.

DESCRIPTION OF BUSINESSES

SALES AND MARKETING SERVICES GROUP (SMSG)

Dedicated Contract Sales Teams

Product detailing involves a representative meeting face-to-face with

targeted physicians and other healthcare decision makers to provide a technical review of the product being promoted. Dedicated contract sales teams work exclusively on behalf of one client and often carry the business cards of the client. Each sales team is customized to meet the specifications of our client with respect to representative profile, physician targeting, product training, incentive compensation plans, integration with clients' in-house sales forces, call reporting platform, program duration and data integration. Without adding permanent personnel, the client gets a high quality, industry-standard sales team comparable to its internal sales force.

Shared Contract Sales Teams

Our shared sales teams sell multiple brands from different pharmaceutical manufacturers. Through them, we make a face-to-face selling resource available to those clients that want an alternative to a dedicated team. The PDI Shared Sales teams are leading providers of these detailing programs in the U.S. Since costs are shared among various companies, these programs may be less expensive for the client than programs involving a dedicated sales force. With a shared sales team, the client still gets targeted coverage of its physician audience within the representatives' geographic territories.

Medical Device and Diagnostics Contract Sales Teams

MD&D contract sales is an outsourced solution for selling medical devices to hospitals, clinics and other healthcare institutions. The MD&D contract sales teams work exclusively on behalf of one client. Each sales team is customized to meet the specifications of our client with respect to representative profile, identified territories, product training, incentive compensation plans, integration with clients' in-house sales forces, activity reporting platform, program duration and data integration. Without adding permanent personnel, the client gets a high quality, industry-standard sales team.

Medical Device and Diagnostics Clinical Sales Teams

Our clinical sales teams employ nurses, medical technologists, and other clinicians who train and provide hands-on clinical education and after sales support to the medical staffs of hospitals and clinics that recently purchased our clients' equipment. Our activities maximize product utilization and customer satisfaction for the medical practitioners, while simultaneously enabling our clients' sales forces to continue their selling activities instead of in-servicing the equipment.

Hybrid Teams

Hybrid teams take elements of the different sales teams outlined above and coordinate their activities to achieve a unique solution for a client. In order to gain greater physician coverage across the country, a client may want to deploy a dedicated team to the large metropolitan markets and supplement that team with a shared team in order to reach additional markets and physicians not reached by the dedicated team. Another example of a hybrid team may be the combination of a sales team with a clinical team when the product requires a sales effort along with clinical support. Hybrid teams enable us to craft custom

solutions for clients with unique challenges.

Marketing Research (Mr&C)

Employing leading edge, and in some instances proprietary, research methodologies, we provide qualitative and quantitative marketing research to pharmaceutical companies with respect to healthcare providers, patients and managed care customers in the U.S. and globally. We offer a full range of pharmaceutical marketing research services, including studies to identify the most impactful business strategy, profile, positioning, message, execution, implementation and post implementation for a product. Correctly implemented, our marketing research model improves the knowledge clients obtain about how

physicians and other healthcare professionals will likely react to products.

We utilize a systematic approach to pharmaceutical marketing research. Recognizing that every marketing need, and therefore every marketing research solution, is unique, we have developed our marketing model to help identify the work that needs to be done in order to identify critical paths to marketing goals. At each step of the marketing model we can offer proven research techniques, proprietary methodologies and customized study designs to address specific product needs.

In addition to conducting marketing research, we have trained several thousand industry professionals at our public seminars. Our professional development seminars focus on key marketing processes and issues.

Medical Education and Communications (Pdi Edcomm and Pharmakon)

Our PDI EdComm group provides medical education and promotional communications to the biopharmaceutical and MD&D industries. Using an expert-driven, customized approach, we provide our clients with integrated advocacy development, accredited continuing medical education (CME), promotions, publication services and interactive sales initiatives to generate incremental value for products.

PDI EdComm creates custom designed programs focusing on optimizing the informed use of our clients' products. Our services are executed through a customized, integrated plan that can be leveraged across the product's entire life cycle. We can meet a wide range of objectives, including advocacy during pre-launch, communicating disease state awareness, supporting a product launch, helping an under-performing brand, fending off new competition and expanding market leadership.

Pharmakon's emphasis is on the creation, design and implementation of interactive peer persuasion programs. Each marketing program can be offered through a number of different venues including teleconferences, dinner meetings, "lunch and learns", and web casts. Within each of its programs, Pharmakon offers a number of services including strategic design, tactical execution, technology support, moderator services and thought leader management.

PDI PRODUCTS GROUP (PPG)

There are occasions when a biopharmaceutical or medical device or diagnostic company would want to outlicense, sell or copromote a product that they own or to which they own the rights. They may not have the capabilities to market a product themselves or they may have other products in their portfolio on which they are concentrating their sales and marketing resources. In this instance, our products group works to create a mutually beneficial partnership arrangement, pursuant to which we utilize our sales, marketing and commercialization capabilities to commercialize the product for our partner. These agreements may require upfront payments, royalty payments, milestone payments and/or other compensation strategies. These agreements generally are riskier for us, but generally have the potential to deliver greater revenues, margins and consistency than our services businesses.

Given the broad array of our service offerings, we are able to provide complete product commercialization capabilities (Integrated Commercialization Services) to pharmaceutical companies on a fee for service basis. The execution of these product sales, marketing and commercialization activities would be substantially similar to those we perform in a copromotion, licensing or product acquisition transaction; however, our fee structure and risk profile would be markedly different.

NATURE OF CONTRACTS BY SEGMENT

Given the customized nature of our business, we utilize a variety of contract structures. Historically, most of our product detailing contracts have been fee for service, I.E., the client pays a fee for a specified package of services. These contracts typically include operational benchmarks, such as a minimum number of sales representatives or a minimum number of calls. Also, our contracts might have a lower base fee offset by built-in incentives we can earn

based on our performance. In these situations, we have the opportunity to earn additional fees, as incentives, based on attaining performance benchmarks.

Our product detailing contracts generally are for terms of one to three years and may be renewed or extended. However, the majority of these contracts are terminable by the client for any reason on 30 to 90 days' notice. These contracts sometimes provide for termination payments in the event they are terminated by the client without cause. While the cancellation of a contract by a client without cause may result in the imposition of penalties on the client, these penalties may not act as an adequate deterrent to the termination of any contract. In addition, we cannot assure you that these penalties will offset the revenue we could have earned under the contract or the costs we may incur as a result of its termination. The loss or termination of a large contract or the loss of multiple contracts could have a material adverse effect on our business, financial condition and results of operations. Contracts may also be terminated for cause if we fail to meet stated performance benchmarks.

Our MR&C, PDI EdComm, and Pharmakon contracts generally are for projects lasting from three to six months. The contracts are terminable by the client and provide for termination payments in the event they are terminated without cause. Termination payments include payment of all work completed to date, plus the cost of any nonrefundable commitments made on behalf of the client. Due to the typical size of the projects, it is unlikely the loss or termination of any individual MR&C, EdComm, or Pharmakon contract would have a material adverse effect on our business, financial condition and results of operations.

The contracts within the products group can be either performance based or fee for service and may require sales, marketing and distribution of product. In performance-based contracts, we typically provide and finance a portion, if not all, of the commercial activities in support of a brand in return for a percentage of product sales. An important performance parameter is normally the level of sales or prescriptions attained by the product during the period of our marketing or promotional responsibility, and in some cases, for periods after our promotional activities have ended.

In May 2001, we entered into a copromotion agreement with Novartis Pharmaceuticals Corporation (Novartis) for the U.S. sales, marketing and promotion rights for Lotensin(R), Lotensin HCT(R) and Lotrel(R). That agreement was scheduled to run through December 31, 2003. On May 20, 2002, that agreement was replaced by two separate agreements: one for Lotensin and another one for Lotrel, Diovan(R) and Diovan HCT(R). The Lotensin agreement called for us to provide promotion, selling, marketing and brand management for Lotensin. In exchange, we were entitled to receive a percentage of product revenue based on certain total prescription (TRx) objectives above specified contractual baselines. Both agreements were scheduled to run through December 31, 2003; however, the Lotrel-Diovan agreement was renewed on December 24, 2003 for an additional one-year period. In February 2004, we were notified by Novartis of its intent to terminate the Lotrel-Diovan contract without cause, effective March 16, 2004 and, as a result, \$28.9 million of anticipated revenue associated with the Lotrel-Diovan contract in 2004 will not be realized. We were compensated under the terms of the agreement

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through the effective termination date. Even though the Lotensin agreement ended December 31, 2003, we are still entitled to receive royalty payments on the sales of Lotensin through December 31, 2004. The royalties earned under this arrangement for the three and nine month periods ended September 30, 2004 were approximately \$441,000 and \$3.4 million, respectively; the royalties earned during the remainder of 2004 are expected to diminish because the product lost its patent protection in February 2004.

On December 31, 2002, we entered into an exclusive licensing agreement with Cellegy Pharmaceuticals, Inc. (Cellegy) for the exclusive North American rights for Fortigel(TM), a testosterone gel product. The agreement is in effect for the commercial life of the product. Cellegy submitted a New Drug Application (NDA) for the hypogonadism indication to the U.S. Food and Drug Administration (FDA) in June 2002. In July 2003, Cellegy received a letter from the FDA rejecting its NDA for Fortigel. Cellegy has told us that it is in discussions with the FDA to determine the appropriate course of action needed to meet deficiencies cited by the FDA in its determination. Under the terms of the agreement, we paid Cellegy a \$15.0 million initial licensing fee on December 31,

2002. Under the terms of the licensing agreement, if it should be enforced (see discussion of the lawsuit below), this nonrefundable payment was made prior to FDA approval and since there is no alternative future use of the licensed rights, we expensed the \$15.0 million payment in December 2002, when incurred. This amount was recorded in other selling, general and administrative expenses in the December 31, 2002 consolidated statements of operations. Pursuant to the terms of the licensing agreement, if it should be enforced (see discussion of lawsuit below), we will be required to pay Cellegy a \$10.0 million incremental license fee milestone payment upon Fortigel's receipt of all approvals required by the FDA (if such approvals are obtained) to promote, sell and distribute the product in the U.S. This incremental milestone license fee, if incurred, will be recorded as an intangible asset and amortized over its estimated useful life, as then determined, which is not expected to exceed the life of the patent. We believe that we will not be required to pay Cellegy the \$10.0 million incremental license fee milestone payment in 2004, and it is unclear at this point when or if Cellegy will get Fortigel approved by the FDA which would trigger our obligation to pay \$10.0 million to Cellegy. Royalty payments to Cellegy over the term of the commercial life of the product would range from 20% to 30% of net sales. As discussed in Note 13, we filed a complaint against Cellegy in December 2003, that alleges, among other things, that Cellegy fraudulently induced us to enter into the licensing agreement, and seeks the return of the \$15.0 million initial licensing fee, plus additional damages caused by Cellegy's conduct. Since we filed the lawsuit, Cellegy is no longer in regular contact with us regarding Fortigel. Thus, for example, we have been informed that Cellegy is in continuing contact with the FDA but we are unaware of the precise FDA status regarding Fortigel (as of September 30, 2004, it had not been approved) and the FDA continued to express concern about the high supraphysiologic Cmax serum testosterone levels achieved in subjects of Fortigel testing. We are also unaware of what steps Cellegy is taking to develop Fortigel, to obtain FDA approval for Fortigel, and/or to arrange for a party to manufacture Fortigel. We have requested this information from Cellegy but have not received full and complete responses from Cellegy. Accordingly, we may not possess the most current and reliable information concerning the current status of, or future prospects relating to Fortigel. The issuance of the non-approvable letter by the FDA concerning Fortigel, however, casts significant doubt upon Fortigel's prospects and whether it will ever be approved. We cannot predict with any certainty whether the FDA will ultimately approve Fortigel for sale in the U.S.

In October 2002, we partnered with Xylos Corporation (Xylos) for the exclusive U.S. commercialization rights to the Xylos XCell(TM) Cellulose Wound Dressing (XCell) wound care products, by entering into an agreement pursuant to which we became the exclusive commercialization partner for the sales, marketing and distribution of the product line in the U.S. On January 2, 2004, we exercised our contractual right to terminate the agreement on 135 days' notice to Xylos since sales of XCell were not sufficient to sustain our role as commercialization partner for the product. We accepted orders for XCell products through May 16, 2004 when the agreement terminated; however, our promotional activities in support of the brand concluded in January 2004. See Notes 6 and 7 to the financial statements for more information. We currently do not anticipate entering into similar commercialization agreements in the MD&D market.

REVENUE RECOGNITION AND ASSOCIATED COSTS

The paragraphs that follow describe the guidelines that we adhere to in accordance with generally accepted accounting principles (GAAP) when recognizing revenue and cost of goods and services in our financial statements. In accordance with GAAP, service revenue and product revenue and their respective direct costs have been shown separately on the income statement.

Historically, we have derived a significant portion of our service revenue from a limited number of clients. Concentration of business in the pharmaceutical services industry is common and the industry continues to consolidate. As a result, we are likely to continue to experience significant client concentration in future periods. For the three months ended September 30, 2004, and 2003 the Company's three largest clients who each individually represented 10% or more of its service revenue, accounted for approximately, in the aggregate, 74.4%, and 72.4%, respectively, of the Company's service revenue. For the nine months ended September 30, 2004, and 2003 the Company's two largest clients who each accounted for 10% or more of its service revenue totaled, in

the aggregate, 64.9%, and 67.0%, respectively, of the Company's service revenue.

SERVICE REVENUE AND PROGRAM EXPENSES

Service revenue is earned primarily by performing product detailing programs and other marketing and promotional services under contracts. Revenue is recognized as the services are performed and the right to receive payment for the services is assured. Revenue is recognized net of any potential penalties until the performance criteria relating to the penalties have been achieved. Performance incentives, as well as termination payments, are recognized as revenue in the period earned and when payment of the bonus, incentive or other payment is assured. Under performance based contracts, revenue is recognized when the performance based parameters are achieved.

Program expenses consist primarily of the costs associated with executing product detailing programs, performance based contracts or other sales and marketing services identified in the contract. Program expenses include personnel costs and other costs associated with executing a product detailing or other marketing or promotional program, as well as the initial direct costs associated with staffing a product detailing program. Such costs include, but are not limited to, facility rental fees, honoraria and travel expenses, sample expenses and other promotional expenses. Personnel costs, which constitute the largest portion of program expenses, include all labor related costs, such as salaries, bonuses, fringe benefits and payroll taxes for the sales representatives and sales managers and professional staff who are directly responsible for executing a particular program. Initial direct program costs are those costs associated with initiating a product detailing program, such as recruiting, hiring, and training the sales representatives who staff a particular product detailing program. All personnel costs and initial direct program costs, other than training costs, are expensed as incurred for service offerings. Product detailing, marketing and promotional expenses related to the detailing of products we distribute are recorded as a selling expense and are included in other selling, general and administrative expenses in the consolidated statements of operations.

Reimbursable Out-of-pocket Expenses

Reimbursable out-of-pocket expenses include those relating to out-of-pocket expenses and other similar costs, for which we are reimbursed at cost from our clients. In accordance with EITF 01-14 reimbursements received for out-of-pocket expenses incurred are characterized as revenue and an identical amount is included as cost of goods and services in the consolidated statements of operations. Out-of-pocket expenses for the three and nine month periods ended September 30, 2004 were \$5.4 million and \$18.0 million, respectively. Out-of-

pocket expenses for the three and nine month periods ended September 30, 2003 were \$8.3 million and \$20.3 million, respectively.

Training and Other Initial Direct Costs

Training costs include the costs of training the sales representatives and managers on a particular product detailing program so that they are qualified to properly perform the services specified in the related contract. For all contracts, training costs are deferred and amortized on a straight-line basis over the shorter of the life of the contract to which they relate or 12 months. When we receive a specific contract payment from a client upon commencement of a product detailing program expressly to compensate us for recruiting, hiring and training services associated with staffing that program, such payment is deferred and recognized as revenue in the same period that the recruiting and hiring expenses are incurred and amortization of the deferred training is expensed. When we do not receive a specific contract payment for training, all revenue is deferred and recognized over the life of the contract.

As a result of the revenue recognition and program expense policies described above, we may incur significant initial direct program costs before recognizing revenue under a particular product detailing program. Our inability to specifically negotiate for payments that are specifically attributable to recruiting, hiring or training services in our product detailing contracts could

adversely impact our operating results for periods in which the costs associated with the product detailing services are incurred.

PRODUCT REVENUE AND COST OF GOODS SOLD

Product revenue is recognized when products are shipped and title is transferred to the customer. Product revenue was negative \$3,000 and negative \$1.0 million for the three and nine months ended September 30, 2004. The negative \$1.0 million for the nine months ended September 30, 2004 was primarily due to the \$1.2 million increase in the Cefin returns reserve as discussed more fully in Note 5. Additionally we had product revenue of \$81,000 and \$197,000 for the three and nine months ended September 30, 2003, respectively, primarily from the sale of the Xylos wound care products.

Cost of goods sold includes all expenses for product distribution costs, acquisition and manufacturing costs of the product sold. Inventory is valued at the lower of cost or market value. Cost is determined using the first-in, first-out costing method. Inventory to date has consisted of only finished goods.

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain consolidated statements of operations data as a percentage of revenue. The trends illustrated in this table may not be indicative of future results.

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<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2004	2003	2004	2003	
	<C>	<C>	<C>	<C>	
		(restated)		(restated)	
Revenue					
Service	100.0%	99.9%	100.4%	99.9%	
Product, net	--	0.1	(0.4)	0.1	
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods and services					
Program expenses	73.6	74.1	73.6	74.3	
Cost of goods sold	--	1.0	0.1	0.4	
Total cost of goods and services	73.6%	75.1%	73.7%	74.7%	
Gross profit	26.4	24.9	26.3	25.3	
Compensation expense	9.1	9.8	9.6	11.1	
Other selling, general and administrative expenses ...	7.5	8.2	6.9	8.4	
Restructuring and other related expenses, net	--	--	--	(0.1)	
Litigation settlement	--	--	--	0.9	
Total operating expenses	16.6	18.0	16.5	20.3	
Operating income	9.8	6.9	9.8	5.0	
Other income, net	0.2	0.3	0.3	0.3	
Income before provision for income taxes	10.0	7.2	10.1	5.3	
Provision for income taxes	4.1	2.8	4.1	2.1	
Net income	5.9%	4.4%	6.0%	3.2%	

</TABLE>

THREE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2003

REVENUE. Revenue for the quarter ended September 30, 2004 was \$92.5 million, 2.1% less than revenue of \$94.6 million for the quarter ended September 30, 2003. Revenue from the SMSG segment for the quarter ended September 30, 2004 was \$92.0 million, 13.1% more than revenue of \$81.3 million from that segment

for the comparable prior year period. The increase is mainly attributable to the higher number of sales representatives contracted for by our dedicated contract sales clients in the quarter ended September 30, 2004 than in the comparable prior year period. PPG revenue for the quarter ended September 30, 2004 was approximately \$515,000, consisting almost entirely of revenue due to Lotensin royalties. The Lotensin royalties earned during the remainder of 2004 are expected to diminish because the product lost its patent protection in February 2004. PPG revenue was \$13.2 million in the comparable prior year period. The Lotensin contract, which was a major contributor in 2003, was completed December 31, 2003 and we will continue to earn Lotensin royalties until December 31, 2004.

COST OF GOODS AND SERVICES. Cost of goods and services for the quarter ended September 30, 2004 was \$68.1 million, comparable to \$71.0 million for the quarter ended September 30, 2003. As a percentage of total revenue, cost of goods and services were 73.6% for the quarter ended September 30, 2004 slightly less than 75.1% in the comparable prior year period. Program expenses (i.e., cost of services) associated with the SMSG segment for the quarter ended September 30, 2004 were \$68.1 million, 11.5% more than program expenses of \$61.1 million for the comparable prior year period. The increase is mainly attributable to the higher number of sales representatives contracted for by our dedicated contract sales clients in the quarter ended September 30, 2004 than in the comparable prior year period. As a percentage of sales and marketing services segment revenue, program expenses for the quarter ended September 30, 2004 decreased to 74.0% from 75.1% in the comparable prior year period. Cost of goods and services associated with the PPG segment were \$11,000 and \$9.9 million for the quarters ended September 30, 2004 and 2003, respectively. This decrease can be primarily attributed to the completion of the Lotensin contract which ended December 31, 2003.

COMPENSATION EXPENSE. Compensation expense for the quarter ended September 30, 2004 was \$8.4 million, 9.6% less than \$9.3 million for the comparable prior year period. The decrease in compensation expense was primarily due to the decreased staffing in support of the product businesses, which have been de-emphasized. As a percentage of total revenue, compensation expense decreased to 9.1% for the quarter ended September 30, 2004 from 9.8% for the quarter ended September 30, 2003. Compensation expense for the quarter ended September 30, 2004 attributable to the SMSG segment was \$8.2 million compared to \$6.2 million for the quarter ended September 30, 2003. This increase can be attributed to a greater amount of internal resources and management's time and effort being expended, related to the SMSG segment in 2004. Compensation expense as a percentage of revenue increased to 8.9% from 7.6% in the comparable prior year period. Compensation expense for the quarter ended September 30, 2004 attributable to the PPG segment was approximately \$216,000 compared to \$3.1 million in the prior year period. This decrease can be attributed to the lower level of resources required after the completion of the Lotensin contract which ended December 31, 2003.

OTHER SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Total other selling, general and administrative expenses were \$6.9 million for the quarter ended September 30, 2004, 9.6% less than other selling, general and administrative expenses of \$7.7 million for the quarter ended September 30, 2003. This decrease is primarily a result of a reduction of sales force and marketing costs related to Xylos, a product we marketed and distributed. During 2003, we incurred approximately \$500,000 in sales force and marketing costs whereas those costs were not incurred for the quarter ended September 30, 2004 as we stopped selling the products on May 16, 2004. As a percentage of total revenue, total other selling, general and administrative expenses decreased to 7.5% for the quarter ended September 30, 2004 from 8.2% for the quarter ended September 30, 2003 due to continuing cost management efforts. Other selling, general and administrative expenses attributable to the SMSG segment for the quarter ended September 30, 2004 were \$6.8 million, compared to other selling, general and administrative expenses of \$5.4 million attributable to that segment for the comparable prior year period. This increase is primarily due to a larger portion of corporate resources being expended on behalf of the SMSG segment in the current period. As a percentage of revenue from sales and marketing services, other selling, general and administrative expenses were 7.4% and 6.6% for the quarters ended September 30, 2004 and 2003, respectively. Other selling, general and administrative expenses attributable to the PPG segment for the quarter ended September 30, 2004 were approximately \$114,000 compared to \$2.3 million for the

comparable prior year period; this decrease can be attributed to the lower level of resources required after the completion of the Lotensin contract which ended December 31, 2003 and the termination of the Xylos agreement.

OPERATING INCOME. Operating income for the quarter ended September 30, 2004 was \$9.0 million, compared to operating income of \$6.5 million for the quarter ended September 30, 2003. Operating income as a percentage of revenue increased to 9.8% for the three months ended September 30, 2004 from 6.9% in the comparable prior year period. Operating income for the quarter ended September 30, 2004 for the SMSG segment was \$8.9 million, or 2.5% higher than the SMSG operating income for the quarter ended September 30, 2003 of \$8.6 million. As a percentage of revenue from the sales and marketing services segment, operating income for that segment decreased to 9.6% for the quarter ended September 30, 2004, from 10.6% for the comparable prior year period. This decrease is primarily due to a larger portion of corporate resources being expended on behalf of the SMSG segment in the current period. There was operating income for the PPG segment for the quarter ended September 30, 2004 of approximately \$174,000, compared to an operating loss of \$2.1 million for the prior year period.

OTHER INCOME, NET. Other income, net, for the quarters ended September 30, 2004 and 2003 was \$230,000 and \$246,000, respectively, and was comprised primarily of interest income.

PROVISION FOR INCOME TAXES. Income tax expense, which consisted of Federal and state corporate income taxes, was \$3.8 million for the quarter ended September 30, 2004, compared to income tax expense of approximately \$2.6 million for the quarter ended September 30, 2003. The effective tax rate for the quarter ended September 30, 2004 was 41.0% and for the quarter ended September 30, 2003 was 38.4%. The rate for the quarter ended September 30, 2003 was lower than the Company's average annual effective rate because the return to profitable operations in 2003 enabled the utilization of tax loss carry-forwards for certain states.

NET INCOME. Net income for the quarter ended September 30, 2004 was approximately \$5.5 million, compared to net income of approximately \$4.2 million for the quarter ended September 30, 2003. This increase is due to the factors discussed above.

NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2003

REVENUE. Revenue for the nine months ended September 30, 2004 was \$276.6 million, 12.8% more than revenue of \$245.3 million in the comparable prior year period. Revenue from the SMSG segment

for the nine months ended September 30, 2004 was \$274.1 million, 30.8% more than revenue of \$209.6 million for the nine months ended September 30, 2003. This increase is mainly attributable to the addition of three significant dedicated contract sales teams contracts in July 2003 which are still ongoing in 2004. PPG revenue for the nine months ended September 30, 2004 was \$2.5 million; that consisted primarily of Lotensin royalties, partially offset by the \$1.2 million of negative revenue that was recognized due to the increase in the Cefitin returns reserve (as discussed more fully in Note 5 to the financial statements). The Lotensin royalties earned during the remaining quarter of 2004 are expected to diminish because the product lost its patent protection in February 2004. PPG revenue was \$35.7 million in the comparable prior year period. The Lotensin contract, which was a major contributor in 2003, was completed December 31, 2003 and we will continue to earn Lotensin royalties until December 31, 2004.

COST OF GOODS AND SERVICES. Cost of goods and services for the nine months ended September 30, 2004 was \$203.9 million, 11.2% more than cost of goods and services of \$183.3 million for the nine months ended September 30, 2003. As a percentage of total revenue, cost of goods and services decreased to 73.7% for the nine months ended September 30, 2004 from 74.7% in the comparable prior year period. Program expenses (i.e., cost of services) associated with the SMSG segment for the quarter ended September 30, 2004 were \$203.7 million, 32.0% more than program expenses of \$154.3 million for the prior year period. This increase is mainly attributable to the addition of three significant dedicated contract

sales teams contracts in July 2003. As a percentage of sales and marketing services segment revenue, program expenses for the nine months ended September 30, 2004 and 2003 were 74.3% and 73.6%, respectively. The reduction in gross profit percentage of 0.7% is primarily attributable to greater incentive payments earned in 2003, and severance and reassignment costs incurred in 2004 associated with programs that terminated early. Cost of goods and services associated with the PPG segment were \$254,000 and \$29.0 million for the nine months ended September 30, 2004 and 2003, respectively. This decrease can be primarily attributed to the completion of the Lotensin contract that ended December 31, 2003. Also, during the nine months ended September 30, 2003, we recognized a \$340,000 net reduction in the restructuring accrual associated with the 2002 Restructuring Plan (see Note 14 and "RESTRUCTURING AND OTHER RELATED EXPENSES" disclosure below for further explanations.)

COMPENSATION EXPENSE. Compensation expense for the nine months ended September 30, 2004 was \$26.5 million, 2.7% less than \$27.3 million for the comparable prior year period. As a percentage of total revenue, compensation expense decreased to 9.6% for the nine months ended September 30, 2004 from 11.1% for the nine months ended September 30, 2003 due to continuing cost management efforts. Compensation expense for the nine months ended September 30, 2004 attributable to the SMSG segment was \$24.6 million compared to \$18.6 million for the nine month period ended September 30, 2003; this increase can be attributed to a greater amount of management's time and effort being expended on behalf of the SMSG segment in 2004. As a percentage of revenue, compensation expense increased to 9.0% from 8.9% in the comparable prior year period. Compensation expense for the nine months ended September 30, 2004 attributable to the PPG segment was \$1.9 million or 75.2% of PPG revenue, compared to \$8.7 million or 24.4% in the prior year period. A large portion of compensation expense through the nine months ended September 30, 2004 attributable to the PPG segment was for severance related activities which occurred in the first quarter of 2004. The decrease from the comparable prior year period can be attributed to the lower level of resources required after the completion of the Lotensin contract which ended December 31, 2003.

OTHER SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Total other selling, general and administrative expenses were \$19.1 million for the nine months ended September 30, 2004, 7.8% less than other selling, general and administrative expenses of \$20.7 million for the nine months ended September 30, 2003. Excluding approximately \$700,000 in legal fee reimbursements from Bayer for the nine months ended September 30, 2003, total other selling, general and administrative expenses are approximately \$2.3 million less for the comparable period in 2004. As a percentage of total revenue, total other selling, general and administrative expenses decreased to 6.9% for the nine months ended September 30, 2004 from 8.4% for the nine months ended September 30, 2003. Other selling, general and administrative expenses attributable to the SMSG segment for the nine months ended September 30, 2004 were \$18.2 million, compared to other selling, general and administrative

expenses of \$12.8 million attributable to that segment for the comparable prior year period. This increase is primarily due to a larger portion of resources and corporate overhead costs being expended on behalf of the SMSG segment in the current period. As a percentage of revenue from sales and marketing services, other selling, general and administrative expenses were 6.6% and 6.1% for the nine months ended September 30, 2004 and 2003, respectively. Other selling, general and administrative expenses attributable to the PPG segment for the nine months ended September 30, 2004 were approximately \$873,000 compared to \$7.9 million for the comparable prior year period; this decrease can be attributed to the lower level of resources required after the completion of the Lotensin contract which ended December 31, 2003 and the termination of the Xylos agreement.

RESTRUCTURING AND OTHER RELATED EXPENSES (CREDITS). For the nine months ended September 30, 2004 we did not recognize any adjustments to the restructuring accrual. During the quarter ended March 31, 2003, we recognized a \$270,000 reduction in the restructuring accrual due to negotiating higher sublease proceeds than originally estimated for the leased facility in Cincinnati, Ohio. During the quarter ended June 30, 2003, we also incurred approximately \$133,000 of additional restructuring expense due to higher than expected contractual termination costs. This additional expense was recorded in program expenses consistent with the original recording of the restructuring

charges. Also during the quarter ended June 30, 2003 we recognized a \$473,000 reduction in the restructuring accrual due to greater success in the reassignment of sales representatives to other programs and the voluntary departure of other sales representatives which combined to reduce the requirement for severance costs. This adjustment was recorded in program expenses consistent with the original recording of the restructuring charges. See the "RESTRUCTURING AND OTHER RELATED EXPENSES" disclosure below for further explanations of the Restructuring Plan and related activity.

LITIGATION SETTLEMENT. On May 8, 2003, we entered into a settlement and mutual release agreement with Auxillium (Settlement Agreement). The settlement terms included a cash payment paid upon execution of the Settlement Agreement and other additional expenses that totaled \$2.1 million. This expense was recorded in the quarter ended March 31, 2003.

OPERATING INCOME. Operating income for the nine months ended September 30, 2004 was \$27.1 million, an increase of 122.9%, compared to operating income of \$12.1 million for the nine months ended September 30, 2003. Operating income as a percentage of revenue increased to 9.8% for the nine months ended September 30, 2004 from 5.0% in the comparable prior year period. This relates to higher revenue and gross margin from the impact of three dedicated sales contracts entered into in July 2003 as well as the impact of management's cost containment efforts. Operating income for the nine months ended September 30, 2004 for the SMSG segment was \$27.6 million, or 20.5% higher than the SMSG operating income for the nine months ended September 30, 2003 of \$22.9 million. As a percentage of revenue from the sales and marketing services segment, operating income for that segment decreased to 10.1% for the nine months ended September 30, 2004, from 10.9% for the comparable prior year period. There was an operating loss for the PPG segment for the nine months ended September 30, 2004 of approximately \$508,000, substantially due to the \$1.2 million increase in the Cefin returns reserve, compared to an operating loss of \$10.7 million for the prior year period.

OTHER INCOME, NET. Other income, net, for the nine months ended September 30, 2004 and 2003 was \$860,000 and \$741,000, respectively, and was comprised primarily of interest income.

PROVISION FOR INCOME TAXES. Income tax expense was \$11.5 million for the nine months ended September 30, 2004, compared to income tax expense of approximately \$5.1 million for the nine months ended September 30, 2003, which consisted of Federal and state corporate income taxes. The effective tax rate for the nine month period ended September 30, 2004 was 41.0%, comparable to an effective tax rate of 39.7% for the nine months ended September 30, 2003. The rate for the nine months ended September 30, 2003 was lower than the Company's average annual effective rate because the return to profitable

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operations in 2003 enabled the utilization of tax loss carry-forwards for certain states. The rate for the quarter ended September 30, 2004 was in line with the expected rate for the year.

NET INCOME. Net income for the nine months ended September 30, 2004 was approximately \$16.5 million, compared to net income of approximately \$7.8 million for the nine months ended September 30, 2003. This increase is due to the factors discussed above.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2004, we had cash and cash equivalents and short-term investments of approximately \$106.3 million and working capital of approximately \$88.0 million, compared to cash and cash equivalents and short-term investments of approximately \$114.6 million and working capital of approximately \$100.0 million at December 31, 2003.

For the nine months ended September 30, 2004, net cash provided by operating activities was \$24.7 million, compared to \$28.6 million net cash provided by operating activities for the nine months ended September 30, 2003. The main components of cash provided by operating activities during the nine months ended September 30, 2004 were:

- o net income of approximately \$16.5 million; and

- o decrease in the net deferred tax asset of approximately \$7.7 million; and
- o depreciation and other non-cash expenses of approximately \$5.7 million which included bad debt expense of approximately \$54,000, stock compensation expense of approximately \$1.1 million and amortization of intangible assets of approximately \$567,000, each of which was charged to SG&A; and loss on disposal of assets of approximately \$264,000, partially offset by
- o a net cash decrease in "other changes in assets and liabilities" of \$5.2 million.

As of September 30, 2004, we had \$2.4 million of unbilled costs and accrued profits on contracts in progress. When services are performed in advance of billing, the value of such services is recorded as unbilled costs and accrued profits on contracts in progress. Normally, all unbilled costs and accrued profits are earned and billed within 12 months from the end of the respective period. Also, as of September 30, 2004, we had \$9.8 million of unearned contract revenue. When we bill clients for services before they have been completed, billed amounts are recorded as unearned contract revenue, and are recorded as revenue when earned.

The net changes in the "Other changes in assets and liabilities" section of the consolidated statement of cash flows may fluctuate depending on a number of factors, including the number and size of programs, contract terms and other timing issues; these variations may change in size and direction with each reporting period. A major net cash outflow in 2004 has been net payments of \$18.2 million to reimburse customers for returns of Cefitin product.

For the nine months ended September 30, 2004, net cash used in investing activities was \$63.8 million. The main components consisted of the following:

- o Approximately \$27.6 million used in the purchase of a laddered portfolio of short-term investments in very high grade debt instruments with a focus on preserving capital, maintaining liquidity, and maximizing returns in accordance with our investment criteria.

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- o Capital expenditures during the nine-month period ended September 30, 2004 were \$7.8 million, almost entirely composed of purchases related to the move to our new corporate headquarters which occurred in July of 2004. The lease at our new location, which replaces our expiring leases, is for approximately 83,000 square feet and has a duration of approximately 12 years at market rates. There was approximately \$1.5 million in capital expenditures for the nine months ended September 30, 2003. For both periods, all capital expenditures were funded out of available cash.

On August 31, 2004, the Company acquired substantially all of the assets of Pharmakon, L.L.C. ("Pharmakon") in a transaction treated as an asset acquisition for tax purposes. The acquisition has been accounted for as a purchase, subject to the provisions of Statement of Financial Accounting Standards (SFAS) 141. The Company made payments to the members of Pharmakon at closing of \$27.4 million, and assumed approximately \$2.6 million in net liabilities. Additional payments of approximately \$1.0 million were made as a result of closing costs. Additionally, the members of Pharmakon can still earn up to an additional \$10 million in cash based upon achievement of certain annual profit targets through December 2006. In connection with this transaction, the Company recorded \$10.6 million in goodwill and \$18.9 million in other identifiable intangible assets.

For the nine months ended September 30, 2004, net cash provided by financing activities of approximately \$3.1 million was due to the net proceeds received from the exercise of stock options and the employee stock purchase plan.

Our revenue and profitability depend to a great extent on our relationships with a limited number of large pharmaceutical companies. For the nine months ended September 30, 2004, we had two major clients that accounted

for, in the aggregate, approximately 43.8% and 21.1%, respectively, or a total of 64.9% of our service revenue. We are likely to continue to experience a high degree of client concentration, particularly if there is further consolidation within the pharmaceutical industry. The loss or a significant reduction of business from any of our major clients, or a decrease in demand for our services, could have a material adverse effect on our business, financial condition and results of operations.

Under our licensing agreement with Cellegy, we will be required to pay Cellegy a \$10.0 million incremental license fee milestone payment upon Fortigel's receipt of all approvals required by the FDA to promote, sell and distribute the product in the U.S. Upon payment, this incremental milestone license fee will be recorded as an intangible asset and amortized over the estimated commercial life of the product, as then determined. This payment will be funded, when due, out of cash flows provided by operations and existing cash balances. In addition, under the licensing agreement, we would be required to pay Cellegy royalty payments ranging from 20% to 30% of net sales, including minimum royalty payments, if and when complete FDA approval is received. The initial 10-month Prescription Drug User Fee Act (PDUFA) date for the product was April 5, 2003. In March 2003, Cellegy was notified by the FDA that the PDUFA date had been revised to July 3, 2003. On July 3, 2003, Cellegy was notified by the FDA that Fortigel was not approved. Cellegy is in discussions with the FDA to determine the appropriate course of action needed to meet deficiencies cited by the FDA in its determination. We cannot predict with any certainty that the FDA will ultimately approve Fortigel for sale in the U.S. Management believes that it will not be required to pay Cellegy the \$10.0 million incremental license fee milestone payment in 2004, and it is unclear at this point when or if Cellegy will get Fortigel approved by the FDA which would trigger our obligation to pay \$10.0 million to Cellegy.

On December 12, 2003, we filed a complaint against Cellegy in the U.S. District Court for the

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Southern District of New York. The complaint alleges that Cellegy fraudulently induced us to enter into a license agreement with Cellegy regarding Fortigel on December 31, 2002. The complaint also alleges claims for misrepresentation and breach of contract related to the license agreement. In the complaint, we seek, among other things, rescission of the license agreement and return of the \$15.0 million we paid Cellegy. After we filed this lawsuit, also on December 12, 2003, Cellegy filed a complaint against us in the U.S. District Court for the Northern District of California. Cellegy's complaint seeks a declaration that Cellegy did not fraudulently induce us to enter the license agreement and that Cellegy has not breached its obligations under the license agreement. We filed an answer to Cellegy's complaint on June 18, 2004, in which we make the same allegations and claims for relief as we do in our New York action, and we also allege Cellegy violated California unfair competition law. By order dated April 23, 2004 our lawsuit was transferred to the Northern District of California where it may be consolidated with Cellegy's action. We are unable to predict the ultimate outcome of these lawsuits.

We believe that our existing cash balances and expected cash flows generated from operations will be sufficient to meet our operating and capital requirements for the next 12 months. We continue to evaluate and review financing opportunities and acquisition candidates in the ordinary course of business.

RESTRUCTURING AND OTHER RELATED EXPENSES

During the third quarter of 2002, we adopted a restructuring plan, the objective of which was to consolidate operations in order to enhance operating efficiencies (the 2002 Restructuring Plan). This plan was primarily in response to the general decrease in demand within our markets for the sales and marketing services segment, and the recognition that the infrastructure that supported these business units was larger than required. We originally estimated that the restructuring would result in annualized SG&A savings of approximately \$14.0 million, based on the level of SG&A spending at the time we initiated the restructuring. However, these savings have been partially offset by incremental SG&A expenses we incurred in subsequent periods, as we have been successful in expanding our business platforms. Substantially all of the restructuring activities were completed as of December 31, 2003.

During the quarter ended March 31, 2003, we recognized a \$270,000 reduction in the restructuring accrual due to negotiating higher sublease proceeds than originally estimated for the leased facility in Cincinnati, Ohio.

During the quarter ended June 30, 2003 we incurred approximately \$133,000 of additional restructuring expense due to higher than expected contractual termination costs. This additional expense was recorded in program expenses consistent with the original recording of the restructuring charges.

Also during the quarter ended June 30, 2003 we recognized a \$473,000 reduction in the restructuring accrual due to lower than expected sales force severance costs. Greater success in the reassignment of sales representatives to other programs and the voluntary departure of other sales representatives combined to reduce the requirement for severance costs. This adjustment was recorded in program expenses consistent with the original recording of the restructuring charges.

The accrual for restructuring and exit costs totaled approximately \$321,000 at September 30, 2004, and is recorded in current liabilities on the accompanying balance sheet.

A roll forward of the activity for the 2002 Restructuring Plan is as follows:

	BALANCE AT DECEMBER 31, (IN THOUSANDS) 2003		BALANCE AT SEPTEMBER 30, ADJUSTMENTS PAYMENTS 2004	
Administrative severance	\$285	\$ --	\$(199)	\$ 86
Exit costs	459	--	(224)	235
	744	--	(423)	321
Sales force severance	--	--	--	--
TOTAL	\$744	\$ --	\$(423)	\$321

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company became aware of the applicability of the accounting pronouncement, EITF 01-14, to the Company's financial statements in September 2004. EITF 01-14 should have been applied to the Company's financial statements beginning with first quarter of 2002. Due to the non-application of EITF 01-14 since 2002, the Company discovered certain errors in the classification of reimbursable out-of-pocket expenses in its consolidated statements of operations since 2002, which are described in Note 1B to the consolidated financial statements in the Form 10-K/A for 2003 and the Form 10-Q/A's for the periods ended March 31, 2004 and June 30, 2004, each of which were filed on November 3, 2004. As a result, the Company determined that a material weakness existed in its disclosure controls regarding the selection and application of generally accepted accounting principles (GAAP), and preparation of the consolidated financial statements through June 30, 2004.

Beginning in September 2004, the Company has taken a series of steps designed to improve the control processes regarding the selection and application of GAAP and preparation and review of the consolidated financial statements. Specifically, key personnel involved in the Company's financial reporting processes have enhanced the process through which authoritative guidance will be monitored on a regular basis. Review of both authoritative guidance and industry practices will be conducted in order to ensure that all new guidance is being complied with in the preparation of the financial statements, related disclosures and periodic filings with the SEC. Additionally, when the Company became aware of the non-application of EITF 01-14, all prior consolidated financial statements which were filed with the SEC since 2002 were reviewed internally and by an outside consultant for compliance with all authoritative guidance and the application of GAAP and such filings were

determined to be in compliance.

The Company will be testing these controls in connection with management's December 31, 2004 evaluation and opinion on the effectiveness of the Company's internal controls.

Based on the Company's evaluation as of September 30, 2004, the Company's management, with the participation of its chief executive officer and chief financial officer, has evaluated the effectiveness of the Company's financial reporting and disclosure controls and procedures (as such terms are defined in Rules 13a-15(e), 13a-15(f), 15d-15(e) and 15d-15(f) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of September 30, 2004. Based on that evaluation, including the improvement in controls and procedures described above, the Company's chief executive officer and chief financial officer have concluded that, as of September 30, 2004, the Company's financial reporting and disclosure controls and procedures are effective.

CHANGES IN INTERNAL CONTROLS

Except as described above in "Evaluation of Disclosure Controls and Procedures", there has been no change in the Company's internal control over financial reporting and disclosure controls (as such terms are defined in Rules 13a-15(e), 13a-15(f), 15d-15(e) and 15d-15(f) under the Exchange Act) that was identified in connection with management's evaluation, as described above, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

SECURITIES LITIGATION

In January and February 2002, we, our chief executive officer and our chief financial officer were served with three complaints that were filed in the United States District Court for the District of New Jersey alleging violations of the Securities Exchange Act of 1934 (the "Exchange Act"). These complaints were brought as purported shareholder class actions under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 established thereunder. On May 23, 2002, the Court consolidated all three lawsuits into a single action entitled In re PDI Securities Litigation, Master File No. 02-CV-0211, and appointed lead plaintiffs ("Lead Plaintiffs") and Lead Plaintiffs' counsel. On or about December 13, 2002, Lead Plaintiffs filed a second consolidated and amended complaint ("Second Consolidated and Amended Complaint"), which superseded their earlier complaints.

The complaint names us, our chief executive officer and our chief financial officer as defendants; purports to state claims against us on behalf of all persons who purchased our common stock between May 22, 2001 and August 12, 2002; and seeks money damages in unspecified amounts and litigation expenses including attorneys' and experts' fees. The essence of the allegations in the Second Consolidated and Amended Complaint is that we intentionally or recklessly made false or misleading public statements and omissions concerning our financial condition and prospects with respect to our marketing of Cefin in connection with the October 2000 distribution agreement with GlaxoSmithKline, our marketing of Lotensin in connection with the May 2001 distribution agreement with Novartis Pharmaceuticals Corporation, as well as our marketing of Evista(R) in connection with the October 2001 distribution agreement with Eli Lilly and Company.

In February 2003, we filed a motion to dismiss the Second Consolidated and Amended Complaint under the Private Securities Litigation Reform Act of 1995 and Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. That motion is fully submitted to the court for its decision. We believe that the allegations in this purported securities class action are without merit and we intend to defend the action vigorously.

BAYER-BAYCOL LITIGATION

We have been named as a defendant in numerous lawsuits, including two class action matters, alleging claims arising from the use of Baycol, a prescription cholesterol-lowering medication. Baycol was distributed, promoted and sold by Bayer in the U.S. through early August 2001, at which time Bayer voluntarily withdrew Baycol from the U.S. market. Bayer retained certain companies, such as us, to provide detailing services on its behalf pursuant to contract sales force agreements. We may be named in additional similar lawsuits. To date, we have defended these actions vigorously and have asserted a contractual right of defense and indemnification against Bayer for all costs and expenses we incur relating to these proceedings. In February 2003, we entered into a joint defense and indemnification agreement with Bayer, pursuant to which Bayer has agreed to assume substantially all of our defense costs in pending and prospective proceedings and to indemnify us in these lawsuits, subject to certain limited exceptions. Further, Bayer agreed to reimburse us for all reasonable costs and expenses incurred to date in defending these proceedings. To date, Bayer has reimbursed us for approximately \$1.6 million in legal expenses.

CELLEGY PHARMACEUTICALS LITIGATION

On December 12, 2003, we filed a complaint against Cellegy in the U.S. District Court for the Southern District of New York. The complaint alleges that Cellegy fraudulently induced us to enter into a license agreement with Cellegy regarding Fortigel on December 31, 2002. The complaint also alleges claims for misrepresentation and breach of contract related to the license agreement. In the complaint, we seek, among other things, rescission of the license agreement and return of the \$15.0 million we paid Cellegy. After we filed this lawsuit, also on December 12, 2003, Cellegy filed a complaint against us in the U.S. District Court for the Northern District of California. Cellegy's complaint seeks a declaration that Cellegy did not fraudulently induce us to enter the license agreement and that Cellegy has not breached its obligations under the license agreement. We filed an answer to Cellegy's complaint on June 18, 2004, in which we make the same allegations and claims for relief as we do in our New York action, and we also allege Cellegy violated California unfair competition law. By order dated April 23, 2004 our lawsuit was transferred to the Northern District of California where it may be consolidated with Cellegy's action. We are unable to predict the ultimate outcome of these lawsuits.

OTHER LEGAL PROCEEDINGS

We are currently a party to other legal proceedings incidental to our business. While management currently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not have a material adverse effect on our consolidated financial statements, litigation is subject to inherent uncertainties. Were we to settle a proceeding for a material amount or were an unfavorable ruling to occur, there exists the possibility of a material adverse effect on our business, financial condition and results of operations.

No material amounts have been accrued for losses under any of the above mentioned matters, as no amounts are considered probable or reasonably estimable at this time.

ITEM 6 - EXHIBITS

Exhibit

No.

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- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of

SIGNATURES

In accordance with the requirements of the Securities and Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereto duly authorized.

November 3, 2004

PDI, INC.
(Registrant)

By: /s/ Charles T. Saldarini

Charles T. Saldarini
Chief Executive Officer

By: /s/ Bernard C. Boyle

Bernard C. Boyle
Chief Financial and Accounting Officer

EXHIBIT 31.1

PDI, INC.

CERTIFICATIONS PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Charles T. Saldarini, certify that:

1. I have reviewed this Form 10-Q for the quarter ended September 30, 2004 of PDI, Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e and 15d-15e) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

/s/ Charles T. Saldarini

Charles T. Saldarini
Vice Chairman and Chief Executive Officer

Date: November 3, 2004

EXHIBIT 31.2

PDI, INC.

CERTIFICATIONS PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Bernard C. Boyle, certify that:

1. I have reviewed this Form 10-Q for the quarter ended September 30, 2004 of PDI, Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e and 15d-15e) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

/s/ Bernard C. Boyle

Bernard C. Boyle
Chief Financial Officer

Date: November 3, 2004

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of PDI, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles T. Saldarini, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Charles T. Saldarini

Charles T. Saldarini
Chief Executive Officer
November 3, 2004

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of PDI, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bernard C. Boyle, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Bernard C. Boyle

Bernard C. Boyle
Chief Financial Officer
November 3, 2004