Pharma-Bio Serv, Inc.
Form 10-Q
March 17, 2011

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

FORM 10-Q

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

For the quarterly period ended January 31, 2011

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

For the transition period from _____________ to ______________

Commission File No. 000-50956

PHARMA-BIO SERV, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	20-0653570 (IRS Employer Identification No.)
Pharma-Bio Serv Building, # 6 Road 696 Dorado, Puerto Rico (Address of Principal Executive Offices)	00646 (Zip Code)

Registrant's Telephone Number, Including Area Code 787-278-2709

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting companyx

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

The number of shares of the registrant’s common stock outstanding as of March 15, 2011 was 20,751,215.

PHARMA-BIO SERV, INC.
FORM 10-Q
FOR THE QUARTER ENDED JANUARY 31, 2011

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PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

PHARMA-BIO SERV, INC.
Condensed Consolidated Balance Sheets
(Unaudited)

	January 31, 2011*	October 31, 2010**
ASSETS:		
Current assets		
Cash and cash equivalents	$2,406,980	$2,317,168
Marketable securities	95,000	95,000
Accounts receivable	3,115,031	2,520,407
Other	203,214	270,827
Total current assets	5,820,225	5,203,402
Property and equipment	1,258,256	1,321,258
Other assets	27,512	33,364
Total assets	$7,105,993	$6,558,024
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities		
Current portion-obligations under capital leases	$18,584	$18,227
Accounts payable and accrued expenses	1,249,706	1,205,576
Income taxes payable	370,288	210,911
Total current liabilities	1,638,578	1,434,714
Obligations under capital leases	49,058	53,839
Total liabilities	1,687,636	1,488,553
Stockholders' equity:		
Preferred Stock, $0.0001 par value; authorized 10,000,000 shares; none outstanding	-	-
Common Stock, $0.0001 par value; authorized 50,000,000 shares; issued and outstanding 20,751,215 shares	2,075	2,075
Additional paid-in capital	648,052	645,886
Retained earnings	4,796,988	4,440,728
Accumulated other comprehensive loss	(28,758)	(19,218)
Total stockholders' equity	5,418,357	5,069,471
Total liabilities and stockholders' equity	$7,105,993	$6,558,024

* Unaudited.
** Condensed from audited financial statements.

See notes to condensed consolidated financial statements.

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PHARMA-BIO SERV, INC.
Condensed Consolidated Statements of Income
(Unaudited)

	Three months ended January 31, 2011	2010
REVENUES	$ 3,592,671	$ 2,556,739
COST OF SERVICES	2,416,663	1,805,563
GROSS PROFIT	1,176,008	751,176
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	658,481	701,861
INCOME FROM OPERATIONS	517,527	49,315
OTHER INCOME (EXPENSE):		
Interest expense	(1,350)	(1,758)
Interest income	4,765	4,664
Gain on disposition of property and equipment	-	1,920
	3,415	4,826
INCOME BEFORE TAXES	520,942	54,141
INCOME TAXES	164,682	33,682
NET INCOME	$ 356,260	$ 20,459
BASIC EARNINGS PER COMMON SHARE	$ 0.017	$ 0.001
DILUTED EARNINGS PER COMMON SHARE	$ 0.016	$ 0.001
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	20,751,215	20,751,215
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED	22,473,941	22,411,328

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended January 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 356,260	$ 20,459
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposition of property and equipment	-	(1,920)
Stock-based compensation	2,166	15,892
Depreciation and amortization	74,713	81,788
(Increase) decrease in accounts receivable	(608,459)	80,868
Decrease in other assets	71,758	93,033
Increase (decrease) in liabilities	209,680	(20,520)
NET CASH PROVIDED BY OPERATING ACTIVITIES	106,118	269,600
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	(10,065)	(11,070)
NET CASH USED IN INVESTING ACTIVITIES	(10,065)	(11,070)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on obligations under capital lease	(4,424)	(21,167)
NET CASH USED IN FINANCING ACTIVITIES	(4,424)	(21,167)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(1,817)	(5,965)
NET INCREASE IN CASH AND CASH EQUIVALENTS	89,812	231,398
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	2,317,168	2,051,874
CASH AND CASH EQUIVALENTS – END OF PERIOD	$ 2,406,980	$ 2,283,272
SUPPLEMENTAL DISCLOURES OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Income taxes	$ 6,025	$ 6,143
Interest	$ 1,350	$ 1,758
SUPPLEMENTARY SCHEDULES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Income tax withheld by clients to be used as a credit in the Company's income tax return	$ 17,801	$ -
Obligations under capital lease incurred for the acquisition of a vehicle	$ -	$ 31,918
Property and equipment with accumulated depreciation of $12,355 disposed during the three month period ended in January 31, 2010	$ -	$ 33,695

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Notes To Condensed Consolidated Financial Statements
January 31, 2011
(Unaudited)

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Pharma-Bio Serv, Inc. (“Pharma-Bio”) is a Delaware corporation organized on January 14, 2004. Pharma-Bio is the parent company of Pharma-Bio Serv PR, Inc. (“Pharma-PR”), Pharma Serv, Inc. (“Pharma-Serv”), both Puerto Rico corporations, Pharma-Bio Serv US, Inc. (“Pharma-US”), a Delaware corporation, and Pharma-Bio Serv Validation & Compliance Limited (“Pharma-IR”), a majority owned Irish corporation. Pharma-Bio, Pharma-PR, Pharma Serv, Pharma-US and Pharma-IR are collectively referred to as the “Company.” The Company operates in Puerto Rico, the United States and in Ireland under the name of Pharma-Bio Serv and is engaged in providing technical compliance consulting service, and microbiological and chemical laboratory testing services primarily to the pharmaceutical, chemical, medical device and biotechnology industries.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated balance sheet of the Company as of October 31, 2010 is derived from audited consolidated financial statements but does not include all disclosures required by generally accepted accounting principles. The unaudited interim condensed consolidated financial statements, include all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations and cash flows for the interim periods. The results of operations for the three months ended January 31, 2011 are not necessarily indicative of expected results for the full 2011 fiscal year.

The accompanying financial data as of January 31, 2011, and for the three-month periods ended January 31, 2011 and 2010 has been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally contained in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes contained in our audited Consolidated Financial Statements and the notes thereto for the fiscal year ended October 31, 2010.

Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and all of its wholly owned and majority-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from these estimates.

Fair Value of Financial Instruments

Accounting standards have established a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Accounting standards have established three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets and liabilities.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

Marketable securities consist of an obligation from the Puerto Rico Government Development Bank valued using quoted market prices in active markets with no valuation adjustment. Accordingly, this security is categorized in Level 1.

The carrying value of the Company's financial instruments (excluding marketable securities and obligations under capital leases): cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, are considered reasonable estimates of fair value due to their liquidity or short-term nature. Management believes, based on current rates, that the fair value of its obligations under capital leases approximates the carrying amount.

Revenue Recognition

Revenue is primarily derived from: (1) time and materials contracts (representing approximately 85% of total revenues), which is recognized by applying the proportional performance model, whereby revenue is recognized as performance occurs, (2) short-term fixed-fee contracts or "not to exceed" contracts (representing approximately 8% of total revenues), which revenue is recognized similarly, except that certain milestones also have to be reached before revenue is recognized, and (3) laboratory testing revenue (representing approximately 7% of total revenues) is mainly recognized as the testing is completed and certified (normally within days of sample receipt from customer). If the Company determines that a contract will result in a loss, the Company recognizes the estimated loss in the period in which such determination is made.

Cash Equivalents

For purposes of the consolidated statements of cash flows, cash equivalents include investments in a money market obligations trust that is registered under the U.S. Investment Company Act of 1940, as amended, and liquid investments with original maturities of three months or less.

Marketable Securities

We consider our marketable security investment portfolio and marketable equity investments available-for-sale and, accordingly, these investments are recorded at fair value with unrealized gains and losses generally recorded in other comprehensive income; whereas realized gains and losses are included in earnings and determined based on the specific identification method.

Accounts Receivable

Accounts receivable are recorded at their estimated realizable value. Accounts are deemed past due when payment has not been received within the stated time period. The Company's policy is to review individual past due amounts periodically and write off amounts for which all collection efforts are deemed to have been exhausted. Due to the nature of the Company’s customers, bad debts are mainly accounted for using the direct write-off method whereby an expense is recognized only when a specific account is determined to be uncollectible. The effect of using this method approximates that of the allowance method.

Income Taxes

The Company follows an asset and liability approach method of accounting for income taxes. This method measures deferred income taxes by applying enacted statutory rates in effect at the balance sheet date to the differences between the tax basis of assets and liabilities and their reported amounts on the financial statements. The resulting deferred tax assets or liabilities are adjusted to reflect changes in tax laws as they occur. A valuation allowance is provided when it is more likely than not that a deferred tax asset will not be realized.

Property and equipment

Owned property and equipment, and leasehold improvements are stated at cost. Equipment and vehicles under capital leases are stated at the lower of fair market value or net present value of the minimum lease payments at the inception of the leases.

Depreciation and amortization of owned assets are provided for, when placed in service, in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, using straight-line basis. Assets under capital leases and leasehold improvements are amortized over the shorter of the estimated useful lives of the assets or initial lease term. Major renewals and betterments that extend the life of the assets are capitalized, while expenditures for repairs and maintenance are expensed when incurred. As of January 31, 2011 and October 31, 2010, the accumulated depreciation and amortization amounted to $1,023,154 and $950,107, respectively.

The Company evaluates for impairment its long-lived assets to be held and used, and long-lived assets to be disposed of, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Based on management estimates, no impairment of the operating properties was present.

Intangible assets

Definite-lived intangible assets, such as customer lists and covenants not to compete, are amortized on a straight-line basis over their estimated useful lives. The Company continually evaluates the reasonableness of the useful lives of these assets.

Stock-based Compensation

Stock-based compensation expense is recognized in the consolidated financial statements based on the fair value of the awards granted. Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of awards that will be forfeited. The Company calculates the fair value of stock options using the Black-Scholes option-pricing model at grant date. Excess tax benefits related to stock-based compensation are reflected as cash flows from financing activities rather than cash flows from operating activities. The Company has not recognized such cash flow from financing activities since there has been no tax benefit related to the stock-based compensation.

Income Per Share of Common Stock

Basic income per share of common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding. Diluted income per share includes the dilution of common stock equivalents.

The diluted weighted average shares of common stock outstanding were calculated using the treasury stock method for the respective periods.

Foreign Operations

The functional currency of the Company’s foreign subsidiary is its local currency. The assets and liabilities of the Company’s foreign subsidiary are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. The cumulative translation effect for subsidiaries using a functional currency other than the U.S. dollar is included as a cumulative translation adjustment in stockholders' equity and as a component of comprehensive income.

The Company's intercompany accounts are typically denominated in the functional currency of the foreign subsidiary. Gains and losses resulting from the remeasurement of intercompany receivables that the Company considers to be of a long-term investment nature are recorded as a cumulative translation adjustment in stockholders' equity and as a component of comprehensive income, while gains and losses resulting from the remeasurement of intercompany receivables from those international subsidiaries for which the Company anticipates settlement in the foreseeable future are recorded in the consolidated statements of operations. The net gains and losses recorded in the condensed consolidated statements of income were not significant for the periods presented.

Reclassifications

Certain reclassifications have been made to the January 31, 2010 condensed consolidated financial statements to conform them to the January 31, 2011 condensed consolidated financial statements presentation. Such reclassifications do not affect net income as previously reported.

Recently issued and adopted accounting standards

Recently issued FASB guidance and SEC Staff Accounting Bulletins have either been implemented or are not applicable to the Company.

NOTE B – MARKETABLE SECURITIES AVAILABLE FOR SALE

At January 31, 2011, the marketable securities of $95,000 consisted of a 5.4% Puerto Rico Commonwealth Government Development Bank Bond, purchased at par and maturing in August 2019. The bond balance approximates its fair market value, therefore no realized or unrealized gains or losses have been recorded.

The primary objectives of the Company's investment portfolio are liquidity and safety of principal. Investments are made with the objective of achieving the highest rate of return consistent with these two objectives. Our investment policy limits investments to certain types of debt and money market instruments issued by institutions primarily with investment grade credit ratings and places restrictions on maturities and concentration by type and issuer.

We review our available-for-sale securities for other-than-temporary declines in fair value below their cost basis on a quarterly basis and whenever events or changes in circumstances indicate that the cost basis of an asset may not be recoverable. This evaluation is based on a number of factors including, the length of time and extent to which the fair value has been less than our cost basis and adverse conditions specifically related to the security including any changes to the rating of the security by a rating agency. As of January 31, 2011, we believe that the cost base for our available-for-sale securities is recoverable in all material respects.

NOTE C - INCOME TAXES

The Company adopted guidance from the FASB related to Accounting for Uncertainty in Income Taxes, which includes a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. As of January 31, 2011, the Company had no significant uncertain tax positions that would be reduced as a result of a lapse of the applicable statute of limitations.

On July 2008, Pharma-Bio and Pharma-PR obtained a Grant of Industrial Tax Exemption ("the Grant") from the Puerto Rico Industrial Development Company pursuant to the terms and conditions set forth in Act No. 135 of December 2, 1997, as amended. The Grant provides relief on various Puerto Rico taxes, including income tax, mostly for the Company's microbiological and chemical laboratory testing facility and service activities outside of Puerto Rico. The Grant is effective as of September 1, 2007 and covers a ten year period. Activities covered by the Grant are subject to a reduced income tax rate of 7%.

The operations carried out in the United States by the Company's subsidiary are taxed in the United States. With certain limitations, the Company receives a credit on its Puerto Rico tax for the federal income tax paid. Also, upon distribution of earnings by the Puerto Rican subsidiary to its parent those dividends are taxed at the federal level, however, the parent is able to receive a credit for the taxes paid by the subsidiary on its operations in Puerto Rico, to the extent of the federal taxes that result from those earnings (determined at rates which are normally lower than in Puerto Rico). As a result, the income tax expense of the Company, under its present corporate structure, would normally be the Puerto Rico taxes on operations in Puerto Rico, plus 10% withholding in Puerto Rico from dividends paid to the Puerto Rican subsidiary's parent, plus federal taxes on operations in the United States.

Deferred income tax assets and liabilities are computed for differences between the consolidated financial statements and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income.

The Company has not recognized deferred income taxes on undistributed earnings of its Puerto Rican subsidiary, since such earnings are considered to be reinvested indefinitely. If the earnings were distributed in the form of dividends, the Company would be subject to a tollgate tax.

Pharma-Bio and Pharma-IR have unused operating losses which result in a potential deferred tax asset. However, an allowance has been provided covering the total amount of such balance since it is uncertain whether the net operating losses can be used to offset future taxable income before their expiration dates. Realization of future tax benefits related to a deferred tax asset is dependent on many factors, including the company's ability to generate taxable income. Accordingly, the income tax benefit will be recognized when realization is determined to be more probable than not. These net operating losses are available to offset future taxable income which expires for Pharma-Bio in 2027 while for Pharma-IR are available indefinitely.

The statutory income tax rate differs from the effective rate mainly due to income tax permanent differences between financial and tax books income.

The Company files income tax returns in the United States (federal and various states jurisdictions), Puerto Rico and Ireland. The 2005 through 2010 tax years are open and may be subject to potential examination in one or more jurisdictions. The Company is not currently under income tax examination.

NOTE D – WARRANTS

At January 31, 2011 and October 31, 2010, the Company had outstanding warrants to purchase shares of the Company's common stock as follows:

	Exercise Price		Expire Date	January 31, 2011	October 31, 2010
Investor Warrants A	$	1.1000	January 25, 2011	-	3,999,700
Investor Warrants B	$	1.6500	January 25, 2011	-	3,999,700
Other Warrants A	$	0.0600	January 16, 2014	249,600	249,600
Other Warrants B	$	0.0600	January 24, 2014	1,830,991	1,830,991
Warrants Total				2,080,591	10,079,991

NOTE E – EARNINGS PER SHARE

The following data shows the amounts used in the calculations of basic and diluted earnings per share.

	Three months ended January 31, 2011	2010
Net income available to common equity holders - used to compute basic and diluted earning per share	$356,260	$20,459
Weighted average number of common shares - used to compute basic earning per share	20,751,215	20,751,215
Effect of warrants to purchase common stock	1,713,323	1,660,113
Effect of options to purchase common stock	9,403	-
Weighted average number of shares - used to compute diluted earnings per share	22,473,941	22,411,328

Warrants for the purchase of 7,999,400 shares of common stock for the three-month periods ended in January 31, 2010 were not included in computing diluted earnings per share because their effects were antidilutive. In addition, options for the purchase of 437,085 and 1,379,413 shares of common stock for the three-month periods ended in January 31, 2011 and 2010, respectively, were not included in computing diluted earnings per share because their effects were also antidilutive.

NOTE F - CONCENTRATIONS OF RISK

Cash and cash equivalents

The Company maintains cash deposits in an FDIC insured bank and in a money market obligations trust, registered under the US Investment Company Act of 1940, as amended. The bank deposit balances frequently exceed federally insured limits. No losses have been experienced or are expected on these accounts.

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Accounts receivable and revenues

Management deems all of its accounts receivable to be fully collectible, and, as such, does not maintain any allowances for uncollectible receivables.

The Company's revenues, and the related receivables, are concentrated in the pharmaceutical industry in Puerto Rico, the United States of America and Ireland. Although a few customers represent a significant source of revenue, the Company’s functions are not a continuous process, accordingly, the client base for which the services are typically rendered, on a project-by-project basis, changes regularly.

The Company provided a substantial portion of its services to three customers, which accounted for 10% or more of its revenues in the three-month periods ended January 31, 2011 and 2010. During the three months ended January 31, 2011, revenues from these customers were 22%, 18%, and 16%, or a total of 56%, as compared to the same period last year for 24%, 14%, and 0%, or a total of 38%, respectively. At January 31, 2011 amounts due from these customers represented 32% of the Company’s total accounts receivable balance.