Pharma-Bio Serv, Inc.
Form 10QSB
September 15, 2008

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended July 31, 2008

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 Small Business Issuer as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	20-0653570 (IRS Employer Identification No.)

Pharma-Bio Serv Building, Industrial Zone Lot 14, Barrio Higuillar, Dorado, Puerto Rico 00646
(Address of Principal Executive Offices)

787-278-2709
(Issuer's Telephone Number, Including Area Code)

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

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

The number of shares outstanding of the registrant's Common Stock as of September 12, 2008 was 20,751,215.

PHARMA-BIO SERV, INC.

FORM 10-QSB

FOR THE QUARTER ENDED JULY 31, 2008

TABLE OF CONTENTS

PHARMA-BIO SERV, INC.
Condensed Consolidated Balance Sheet (Unaudited)
July 31, 2008

ASSETS:		
Current assets		
Cash and cash equivalents	$	2,207,077
Accounts receivable		4,100,799
Other		232,882
Total current assets		6,540,758
Property and equipment		1,555,205
Other assets, mainly intangible assets		80,625
Total assets	$	8,176,588
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities		
Current portion-obligations under capital leases	$	50,285
Accounts payable and accrued expenses		1,330,407
Due to affiliate		2,661,531
Income taxes payable		246,000
Total current liabilities		4,288,223
Long-term liabilities		91,072
Total liabilities		4,379,295
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
Additional paid-in capital		615,123
Retained earnings		3,189,049
Accumulated other comprehensive loss		(8,954)
Total stockholders' equity		3,797,293
Total liabilities and stockholders' equity	$	8,176,588

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Condensed Consolidated Statements of Income (Unaudited)
For the Three-Month and the Nine-Month Periods Ended July 31, 2008 and 2007

	Three months ended July 31, 2008	Three months ended July 31, 2007	Nine months ended July 31, 2008	Nine months ended July 31, 2007
REVENUES	$ 4,191,873	$ 4,540,730	$ 11,493,969	$ 12,295,868
COST OF SERVICES	2,547,992	2,512,377	7,129,868	7,107,828
GROSS PROFIT	1,643,881	2,028,353	4,364,101	5,188,040
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	802,194	761,629	2,304,118	2,236,180
INCOME FROM OPERATIONS	841,687	1,266,724	2,059,983	2,951,860
OTHER INCOME (EXPENSES):				
Interest expense	(46,670)	(88,546)	(179,988)	(302,348)
Interest income	11,492	24,090	69,364	67,845
Loss on disposition of property and equipment	-	-	-	(25,661)
	(35,178)	(64,456)	(110,624)	(260,164)
INCOME BEFORE TAXES	806,509	1,202,268	1,949,359	2,691,696
INCOME TAXES	291,631	507,740	806,574	1,149,440
NET INCOME	$ 514,878	$ 694,528	$ 1,142,785	$ 1,542,256
BASIC EARNINGS PER COMMON SHARE	$ 0.03	$ 0.04	$ 0.06	$ 0.08
DILUTED EARNINGS PER COMMON SHARE	$ 0.02	$ 0.03	$ 0.05	$ 0.07
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	19,892,186	19,615,539	19,708,428	19,315,415
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED	22,210,816	22,067,885	22,153,259	22,092,848

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the Three-Month and the Nine-Month Periods Ended July 31, 2008 and 2007

	Three months ended July 31,		Nine months ended July 31,	
	2008	**2007**	**2008**	**2007**
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	$ 514,878	$ 694,528	$ 1,142,785	$ 1,542,256
Adjustments to reconcile net income to net cash provided by operating activities:				
Loss on disposition of property and equipment	-	-	-	25,661
Stock-based compensation	41,954	26,537	116,972	91,911
Depreciation and amortization	54,046	51,913	157,745	159,570
Imputed interest expense	44,600	86,302	173,766	295,031
(Increase) decrease in accounts receivable	(866,618)	(561,348)	(540,304)	1,223,268
(Increase) decrease in other assets	(60,453)	(66,738)	36,331	182,798
Increase (decrease) in liabilities	(210,727)	(219,739)	(528,861)	312,584
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(482,320)	11,455	558,434	3,833,079
CASH FLOWS FROM INVESTING ACTIVITIES:				
Acquisition of property and equipment	(41,128)	(22,090)	(742,598)	(40,170)
NET CASH USED IN INVESTING ACTIVITIES	(41,128)	(22,090)	(742,598)	(40,170)
CASH FLOW FROM FINANCING ACTIVITIES:				
Proceeds from issuance of common stock	382,861	-	382,861	-
Payments on obligations under capital lease	(12,004)	(9,815)	(33,986)	(28,863)
Payments to affiliate	-	-	(2,750,000)	(2,750,000)
NET CASH PROVIDED BY (USED IN) IN FINANCING ACTIVITIES	370,857	(9,815)	(2,401,125)	(2,778,863)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(152,591)	(20,450)	(2,585,289)	1,014,046
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	2,359,668	3,309,531	4,792,366	2,275,035
CASH AND CASH EQUIVALENTS – END OF PERIOD	$ 2,207,077	$ 3,289,081	$ 2,207,077	$ 3,289,081

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:								
Cash paid during the period for:								
Income taxes	$	616,981	$	593,329	$	1,005,323	$	743,329
Interest	$	2,070	$	2,245	$	351,356	$	511,026
SUPPLEMENTARY SCHEDULES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:								
Accounts payable incurred in projects in process	$	-	$	-	$	84,306	$	-
Income tax withheld by clients to be used as a credit in the Company's income tax return	$	-	$	-	$	-	$	53,573
Obligations under capital lease incurred for the acquisition of a vehicle	$	-	$	-	$	33,695	$	-
Conversion of cashless exercises warrants to shares of common stock	$	-	$	-		-	$	$ 130

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited)
For the Nine-Month Period Ended July 31, 2008

	Common Stock		Preferred Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income	
	Shares	Amount	Shares	Amount	Capital	Earnings	(Loss)	Total
BALANCE AT OCTOBER 31, 2007	19,615,539	$ 1,961	-	$ -	$ 115,404	$ 2,046,264	$ 3,554	$ 2,167,183
CONVERSION OF WARRANTS TO SHARES OF COMMON STOCK	1,135,676	114	-	-	382,747	-	-	382,861
STOCK-BASED COMPENSATION	-	-	-	-	116,972	-	-	116,972
COMPREHENSIVE INCOME:								
NET INCOME	-	-	-	-	-	1,142,785	-	1,142,785
OTHER COMPREHENSIVE LOSS:								
FOREIGN CURRENCY TRANSLATION ADJUSTMENT	-	-	-	-	-	-	(12,508)	(12,508)
OTHER COMPREHENSIVE LOSS								(12,508)
COMPREHENSIVE INCOME								1,130,277
BALANCE AT JULY 31, 2008	20,751,215	$ 2,075	-	$ -	$ 615,123	$ 3,189,049	$ (8,954)	$ 3,797,293

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Notes To Condensed Consolidated Financial Statements (Unaudited)
For the Three-Month and Nine-Month Periods Ended July 31, 2008 and 2007

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”), a Puerto Rico corporation, 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-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 services primarily to the pharmaceutical, chemical, medical device and biotechnology industries.

Pharma-US is a wholly owned subsidiary, which was organized in Delaware in July 2008. As of July 31, 2008, this subsidiary was in development stage and has not incurred significant revenues or expenses.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited condensed consolidated financial statements for the three-month and nine-month periods ended on July 31, 2008 and 2007 presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with the instructions to Form 10-QSB and Regulation S-B pertaining to interim financial statements and reflect all adjustments, consisting of normal recurring adjustments and accruals which, in the opinion of management, are considered necessary for a fair presentation of the Company’s financial position, results of operations and cash flows. Results of operations for interim periods are not necessarily indicative of the results that may be expected for the full year.

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 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

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

-7-

Revenue Recognition

Revenue is primarily derived from: (1) time and materials contracts (representing approximately 90% of total revenues), which is recognized by applying the proportional performance model, whereby revenue is recognized as performance occurs, and (2) short-term fixed-fee contracts or "not to exceed" contracts (representing approximately 10% of total revenues), which revenue is recognized similarly, except that certain milestones also have to be reached before revenue is recognized. If the Company determines that a fixed-fee or “not to exceed” 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 condensed 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 and liquid investments with original maturities of three months or less.

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 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 the provisions of Statement of Financial Accounting Standards Board No. 109, "Accounting for Income Taxes," which requires 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 amount 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 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.

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

Effective November 1, 2006, the Company adopted the provisions of SFAS No. 123R, “Share-Based Payment” (“SFAS 123R”), and Staff Accounting Bulletin No. 107 (“SAB 107”) using the modified prospective method, which results in the provisions of SFAS 123R being applied to the consolidated financial statements on a prospective basis. Under the modified prospective recognition method, restatement of consolidated income from prior periods is not required, and accordingly, the Company has not provided such restatements. Under the modified prospective provisions of SFAS 123R, compensation expense is recorded for the unvested portion of previously granted awards that were outstanding on November 1, 2006 and all subsequent awards. SFAS 123R requires that all stock-based compensation expense be recognized in the consolidated financial statements based on the fair value of the awards. 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. SFAS 123R also amends SFAS No. 95, “Statement of Cash Flows”, to require that excess tax benefits related to stock-based compensation be reflected as cash flows from financing activities rather than cash flows from operating activities. The Company does not recognize 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 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 July 31, 2007 interim condensed consolidated financial statements to conform them to the July 31, 2008 interim condensed consolidated financial statements presentation. Such reclassifications do not have a material effect on net income as previously reported.

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

1. In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, *Business Combinations (*"SFAS 141R"). SFAS 141R requires: the assets acquired and liabilities assumed to be measured at fair value as of the acquisition date; liabilities related to contingent consideration to be remeasured at fair value at each subsequent reporting period; and acquisition-related costs to be expensed as