

Pharma-Bio Serv, Inc.  
Form 10-Q  
March 17, 2010

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 January 31, 2010

- 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  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

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Non-accelerated filer

Smaller reporting company

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

The number of shares of the registrant's common stock outstanding as of March 15, 2010 was 20,751,215.

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PHARMA-BIO SERV, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED JANUARY 31, 2010

TABLE OF CONTENTS

	Page
<b>PART I FINANCIAL INFORMATION</b>	
<b>Item 1 – Financial Statements</b>	
Condensed Consolidated Balance Sheets as of January 31, 2010 and October 31, 2009 (unaudited)	3
Condensed Consolidated Statements of Income for the three-month periods ended January 31, 2010 and 2009 (unaudited)	4
Condensed Consolidated Statements of Cash Flows for the three-month periods ended January 31, 2010 and 2009 (unaudited)	5
Notes to Condensed Consolidated Financial Statements (unaudited)	6
<b>Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations</b>	<b>12</b>
<b>Item 4 – Controls and Procedures</b>	<b>17</b>
<b>PART II OTHER INFORMATION</b>	
<b>Item 1 – Legal Proceedings</b>	<b>18</b>
<b>Item 6 – Exhibits</b>	<b>18</b>
<b>SIGNATURES</b>	<b>19</b>

## PART I – FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

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

	January 31, 2010 *	October 31, 2009 **
<b>ASSETS:</b>		
Current assets		
Cash and cash equivalents	\$ 2,283,272	\$ 2,051,874
Accounts receivable	1,928,077	2,034,963
Other	205,557	298,830
Total current assets	4,416,906	4,385,667
Property and equipment	1,511,891	1,567,145
Other assets	66,302	69,469
Total assets	\$ 5,995,099	\$ 6,022,281
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Current portion-obligations under capital leases	\$ 25,176	\$ 43,737
Accounts payable and accrued expenses	1,051,798	1,112,739
Income taxes payable	167,982	140,443
Total current liabilities	1,244,956	1,296,919
Obligations under capital leases, less current portion	68,437	62,385
Total liabilities	1,313,393	1,359,304
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	618,400	602,508
Retained earnings	4,089,276	4,068,817
Accumulated other comprehensive loss	(28,045)	(10,423)
Total stockholders' equity	4,681,706	4,662,977
Total liabilities and stockholders' equity	\$ 5,995,099	\$ 6,022,281

\* Unaudited.

\*\* Condensed from audited financial statements.

See notes to condensed consolidated financial statements.

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

	Three months ended January 31,	
	2010	2009
REVENUES	\$ 2,556,739	\$ 2,893,516
COST OF SERVICES	1,805,563	2,031,782
GROSS PROFIT	751,176	861,734
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	701,861	711,916
INCOME FROM OPERATIONS	49,315	149,818
OTHER INCOME (EXPENSE):		
Interest expense	(1,758)	(44,616)
Interest income	4,664	11,095
Gain on disposition of property and equipment	1,920	7,950
	4,826	(25,571)
INCOME BEFORE TAXES	54,141	124,247
INCOME TAXES	33,682	104,801
NET INCOME	\$ 20,459	\$ 19,446
BASIC EARNINGS PER COMMON SHARE	\$ 0.001	\$ 0.001
DILUTED EARNINGS PER COMMON SHARE	\$ 0.001	\$ 0.001
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	20,751,215	20,751,215
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED	22,411,328	22,554,394

See notes to condensed consolidated financial statements.

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

	Three months ended January 31,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 20,459	\$ 19,446
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposition of property and equipment	(1,920)	(7,950)
Stock-based compensation	15,892	17,777
Depreciation and amortization	81,788	92,665
Imputed interest expense	-	43,108
Decrease in accounts receivable	80,868	1,033,921
Decrease (increase) in other assets	93,033	(40,333)
Decrease in liabilities	(20,520)	(223,486)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>269,600</b>	<b>935,148</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(11,070)	(58,118)
Payments for business assets acquisition	-	(150,394)
Proceeds from sale of property and equipment	-	12,400
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(11,070)</b>	<b>(196,112)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on obligations under capital lease	(21,167)	(11,034)
Payments to affiliate	-	(2,250,000)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(21,167)</b>	<b>(2,261,034)</b>
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(5,965)	(1,095)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>231,398</b>	<b>(1,523,093)</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>	<b>2,051,874</b>	<b>3,087,990</b>
<b>CASH AND CASH EQUIVALENTS – END OF PERIOD</b>	<b>\$ 2,283,272</b>	<b>\$ 1,564,897</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:</b>		
Cash paid during the period for:		
Income taxes	\$ 6,143	\$ 190,007
Interest	\$ 1,758	\$ 1,507
<b>SUPPLEMENTARY SCHEDULES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Income tax withheld by clients to be used as a credit in the Company's income tax return	\$ -	\$ 4,013
Obligations under capital lease incurred for the acquisition of a vehicle	\$ 31,918	\$ -
Property and equipment with accumulated depreciation of \$12,355 and \$27,544 disposed during the three month periods ended in January 31, 2010 and 2009, respectively	\$ 33,695	\$ 31,995

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.  
Notes To Condensed Consolidated Financial Statements  
January 31, 2010  
(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.

Pharma-US and Pharma Serv are wholly owned subsidiaries. As of January 31, 2010, both subsidiaries were in development stage and have not incurred significant revenues or expenses.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated balance sheet of the Company as of October 31, 2009 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, 2010 are not necessarily indicative of expected results for the full 2010 fiscal year.

The accompanying financial data as of January 31, 2010, and for the three-month periods ended January 31, 2010 and 2009 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, 2009.

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

The carrying value of the Company's financial instruments (excluding 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.

-6-

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## 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.

## 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, 2010 and October 31, 2009, the accumulated depreciation and amortization amounted to \$725,183 and \$660,750, 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.

-7-

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## 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, 2009 condensed consolidated financial statements to conform them to the January 31, 2010 condensed consolidated financial statements presentation. Such reclassifications do not affect net income as previously reported.

## NOTE B - RECENTLY ISSUED AND ADOPTED ACCOUNTING STANDARDS

1. In June 2009, the Financial Accounting Standards Board ("FASB") approved the FASB Accounting Standards Codification (the "Codification") as the single source of authoritative non-governmental generally accepted accounting principles ("GAAP"). All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the SEC, have been superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification has become nonauthoritative. The Codification did not change GAAP, but instead introduced a new structure that combines all authoritative standards into a comprehensive, topically organized online database. The

Codification is effective for interim or annual periods ending after September 15, 2009, and impacts the Company's condensed consolidated financial statements, as all future references to authoritative accounting literature will be referenced in accordance with the Codification. As a result of the Company's implementation of the Codification, previous references to new accounting standards and literature are no longer applicable.

-8-

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2. The FASB issued guidance related to the accounting for business combinations and related disclosures which is effective for fiscal years beginning on or after December 15, 2008. This new guidance addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. The guidance also establishes expanded disclosure requirements for business combinations. Accordingly, the Company will apply this new guidance prospectively to all business combinations subsequent to November 1, 2009. The nature and magnitude of the specific effects of this standard will depend upon the nature, terms and size of the acquisitions the Company completes after the effective date, if any.

3. The FASB issued guidance related to the accounting for noncontrolling interests in consolidated financial statements which is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. This guidance establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This guidance requires that noncontrolling interests in subsidiaries be reported in the equity section of the controlling company's balance sheet. It also changes the manner in which the net income of the subsidiary is reported and disclosed in the controlling company's income statement. Accordingly, the Company adopted this new standard effective November 1, 2009. The adoption of this guidance did not have a significant effect on the Company's financial statements.

#### 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, 2010, 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.

-9-

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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 2004 through 2009 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 - DUE TO AFFILIATE

Pursuant to a plan and agreement of merger dated January 25, 2006, the Company agreed to pay its then sole stockholder of Pharma-PR three installments of \$2,750,000 on January 25, 2007, 2008 and 2009, including imputed interest of 6.72%. The last installment was paid in full during fiscal year 2009.

#### NOTE E – WARRANTS

At January 31, 2010 and October 31, 2009 the Company had outstanding warrants to purchase 10,079,991 and 11,053,216 shares of the Company's common stock, respectively, at prices ranging from \$0.06 to \$1.65 per share. The warrants became exercisable at various dates commencing in 2004 and expire at various dates through 2014. An aggregate of 973,225 of Series C Common Stock Purchase Warrants of the Company with an exercise price of \$0.7344 expired on January 24, 2010.

#### NOTE F – 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,	
	2010	2009
Net income available to common equity holders - used to compute basic and diluted earning per share	\$ 20,459	\$ 19,446
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	1,660,113	1,803,179
Effect of options to purchase common stock	-	-
Weighted average number of shares - used to compute diluted earnings per share	22,411,328	22,554,394

Warrants for the purchase of 7,999,400 and 8,972,625 shares of common stock for the three-month periods ended in January 31, 2010 and 2009, respectively, were not included in computing diluted earnings per share because their effects were antidilutive. In addition, options for the purchase of 1,379,413 and 1,426,944 shares of common stock for the three-month periods ended in January 31, 2010 and 2009, respectively, were not included in computing diluted earnings per share because their effects were also antidilutive.



NOTE G - 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.

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, 2010 and 2009. During the three months ended January 31, 2010, revenues from these customers were 18%, 13%, and 10%, or a total of 41%, as compared to the same period last year for 29%, 7%, and 23%, or a total of 59%, respectively. At January 31, 2010 amounts due from these customers represented 30% of the Company's total accounts receivable balance.

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

The following discussion of our results of operations and financial condition should be read in conjunction with the financial statements and the related notes included under Part I Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited Consolidated Financial Statements and notes thereto and related Management's Discussion and Analysis appearing in our Annual Report on Form 10-K for the year ended October 31, 2009. The following discussion includes forward-looking statements. For a discussion of important factors that could cause actual results to differ from results discussed in the forward-looking statements, see "Forward Looking Statements" below and the "Risk Factors" section in our Annual Report on Form 10-K for the year ended October 31, 2009.

### Overview

We are a compliance and technology transfer services consulting firm with a laboratory testing facility with headquarters in Puerto Rico, servicing the Puerto Rico, United States and Europe markets. The compliance consulting service sector in those markets consists of local compliance and validation consulting firms, United States dedicated validation and compliance consulting firms and large publicly traded and private domestic and foreign engineering and consulting firms. We provide a broad range of compliance related consulting services. We also provide microbiological testing services and anticipate providing chemical testing services through our laboratory testing facility ("Lab") in Puerto Rico. We also provide information technology consulting services and technical trainings/seminars, which services are not currently significant to our operating results. We market our services to pharmaceutical, chemical, biotechnology and medical devices, and allied products companies in Puerto Rico, the United States and Europe. Our staff includes more than 110 experienced engineering and life science professionals, and includes former quality assurance managers or directors, and experienced and trained professionals with bachelors, masters and doctorate degrees in health sciences and engineering.

We expanded the markets we serve from Puerto Rico to the United States and Ireland. We have offices in the United States and Ireland markets since fiscal years 2006 and 2008, respectively. Our Ireland operation, with an Ireland based management team reporting to our headquarters, has established a network of potential key customers and contacts that serve as the base for our sales target and opportunities. We are also actively pursuing to further expand our US market.

We have plans to further penetrate the markets we currently serve. We market our services with an active presence in industry trade shows, professional conventions, industry publications and company provided seminars to the industry. Our senior management is also actively involved in the marketing process, especially in marketing to major accounts. Our senior management and staff also concentrate on developing new business opportunities and focus on the larger customer accounts (by number of professionals or dollar volume) and responding to prospective customers' requests for proposals.

While our core business is US Food and Drug Administration ("FDA") and international agencies regulatory compliance related services, we feel that our clients are in need of other services that we can provide and allow us to present the company as a global solution provider with a portfolio of integrated services that will bring value added solutions to our customers. Accordingly, we expanded our portfolio of services to include a laboratory testing facility, an information technology consulting practice and a training center that provides seminars/trainings to the industry.

Our Lab located in Puerto Rico, with an investment of \$1.25 million for microbiology testing, commenced operations in early fiscal 2009. The Lab incorporates the latest technology and test methodologies meeting pharmacopoeia industry standards and regulations. It currently offers microbiological testing and related services to our core industries already serviced as well as the cosmetic and food industries. The Lab will expand its services to include

chemical and environmental testing at an approximate investment of \$280,000 which was incurred during fiscal year 2009 and will be further incurred in fiscal year 2010.

We identified the industry need, and the opportunity to provide, technical seminars/trainings that will incorporate the latest regulatory trends and standards as well as other related areas. A network of leading industry professional experts in their field, which includes resources of our own, were identified and teamed to provide these seminars/trainings to the industry through our "Pharma Serv Academy" division. Our goal is to provide these services and market our company in the markets we currently serve as well as others.

-12-

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In December 2008, we acquired the operations and assets of Integratek Corp. (“Integratek”), an information technology services and consulting firm based in Puerto Rico. Integratek provides a variety of information technology services such as web pages and portals development, digital art design, intranets, extranets, software development including database integration, Windows and web applications development, software technical training and learning management systems, technology project management, and compliance consulting services, among others. Integratek is a Microsoft Certified Partner and a reseller for technology products from leading vendors in the market. Although this operation is not currently significant to our operating results, our goal is to broaden the portfolio of services that we can provide to our customer base and also target other potential customers in other industries.

In line with the strategy to penetrate the US market, on July 1, 2009 we obtained the renewal of the certification as a "minority-controlled company" as defined by the National Minority Supplier Development Council and Growth Initiative ("NMSDC"). The certification allows us to participate in corporate diversity programs available from various potential customers in the United States and Puerto Rico. The certification is subject to renewal on July 1, 2010.

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 our new Lab 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%.

Although we believe we have instituted the right strategies to be profitable and seek growth, we cannot control the fact that the industry and the local and global economies are undergoing a recession and that has affected our operation and business growth.

The reduction in operations of some of our clients, mostly triggered by the global economic recession and the industry worldwide consolidation, continues to affect our revenues and our growth plans for our fiscal year 2010. For the quarter ended January 31, 2010 our total net revenues decreased by approximately \$0.3 million or 11.6%, when compared to the same period last year. In order to maintain volume in the markets we serve and ensure we are price competitive, we continue to adjust our pricing and gross margin structure accordingly. In addition, since fiscal year 2009 we implemented cost containment measures and have refocused the overall operations strategy to reduce our overhead costs. These factors have led our quarter ended January 31, 2010 income before taxes to be approximately \$34,000, a decline of \$71,000 or a reduction in profit margin before taxes of 2.3 percentage points when compared with the same period last year. Although income before taxes sustained a decline, due to variances in permanent income tax differences between financial and taxable income, net income for the quarter ended January 31, 2010 remained constant at approximately \$20,000 when compared to the same period last year.

The following table sets forth information as to our revenue for the three-month periods ended January 31, 2010 and 2009, by geographic regions (dollars in thousands).

Revenues by Region:	Three months ended January 31,					
	2010		2009			
Puerto Rico	\$	1,706	66.7%	\$	2,143	74.1%
United States		269	10.5%		601	20.8%
Ireland		582	22.8%		150	5.1%
	\$	2,557		\$	2,894	

We believe that our future profitability and liquidity will be highly dependent on the effect the global economy, changes in tax laws and worldwide industry consolidations will have over our operations, and our ability to seek service opportunities and adapt to the current industry trends.



## Results of Operations

The following table sets forth our statements of operations for the three-month periods ended January 31, 2010 and 2009, (dollars in thousands) and as a percentage of revenue:

	Three months ended January 31,			
	2010		2009	
Revenues	\$ 2,557	100.0%	\$ 2,894	100.0%
Cost of services	1,806	70.6%	2,032	70.2%
Gross profit	751	29.4%	862	29.8%
Selling, general and administrative costs	702	27.5%	712	24.6%
Interest expense	2	0.1%	45	1.6%
Interest income	5	-0.2%	11	-0.4%
Gain on disposition of property	2	-0.1%	8	-0.3%
Income before income taxes	54	2.1%	124	4.3%
Income tax expense	34	1.3%	105	3.6%
Net income	20	0.8%	19	0.7%

Revenues. Revenues for the three months ended January 31, 2010 were \$2.6 million, a decrease of approximately \$0.3 million or 11.6%, when compared to the same period last year. The reduction is mainly attributable to the decrease of approximately \$0.5 million and \$0.3 million in the Puerto Rico and the United States market consulting service revenue, respectively, partially offset by \$0.4 million revenue increase in the Ireland consulting operation and an aggregate of \$0.1 million revenue increase in our Lab, Integratek and Academy divisions.

Decreases in the Puerto Rico and United States revenue are mostly due to the global economic recession and the closing of, or decrease in, operations of some pharmaceutical plants, triggered by operations consolidation. The increase in the Ireland operation is mostly attributable to consulting volume acquired from one customer.

Cost of Services; gross margin. The overall gross margin for the three-month period ended in January 31, 2010 reflected a gross margin net reduction of 0.4 percentage points when compared to the same period last year. The net decrease is attributable to the unfavorable effect over gross margin of the Lab by 2.4 percentage points, partially offset by a gain of 2.0 percentage points in the consulting business.

The net decline in the gross margin ratio for the three month period ended in January 31, 2010, as compared to last year, is mainly attributable to the Lab's low gross margin yield as a function of billings versus fixed costs of services, partially offset by gains from some non recurring consulting service projects.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months period ended January 31, 2010 were approximately \$0.7 million, similar to the amount incurred in the same period last year and inclusive of the cost containment measures adopted since fiscal year 2009.

Interest Expense. The interest expense favorable variance for the three months period ended in January 31, 2010 as compared to the same period last year was approximately \$43,000. Until January 2009 we recognized imputed interest expense incurred in connection with the long-term obligations originated pursuant to a plan and agreement of merger dated January 25, 2006 for the acquisition of Pharma-PR. This obligation ceased when the final installment related to this agreement was made in fiscal year 2009. The expense decreased as annual payments were made through fiscal year 2009.

Income Taxes Expense. The decrease in income taxes expense is attributable to the decrease of income before income tax. The statutory income tax rate differs to the effective rate mainly due to income tax permanent differences between

financial and taxable books income.

Net Income. Our net income for the three months period ended January 31, 2010 was approximately \$20,000, an amount similar to the net income for the same period last year.

-14-

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For the three months period ended in January 31, 2010 and 2009, earnings per common share basic and diluted were \$0.001.

Our net income was affected by the decrease in overall gross margin, new operations selling general and administrative expenses partially offset by cost containment measures, favorable variances in interest expense, and the reduction of income tax expense due to the decline in taxable income.

#### Liquidity and Capital Resources

Liquidity is a measure of our ability to meet potential cash requirements, including planned capital expenditures. For the three months ended January 31, 2010, we have generated cash flow from operations of approximately \$0.3 million and a working capital increase of approximately \$0.7 million.

Our primary cash needs consist of the payment of compensation to our professional staff, overhead expenses, and statutory taxes. Management believes that based on current level of operations and cash flows from operations, the collectability of high quality customer receivables will be sufficient to fund anticipated expenses and satisfy other possible long-term contractual commitments for the next twelve months.

To the extent that we pursue possible opportunities to expand our operations, either by acquisition or by the establishment of operations in a new locale, we will incur additional overhead, and there may be a delay between the period we commence operations and our generation of net cash flow from operations.

While uncertainties relating to the current local and global economic condition, competition, the industries and geographical regions served by us and other regulatory matters exist within the consulting services industry, management is not aware of any trends or events likely to have a material adverse effect on liquidity or its financial statements.

#### Off-Balance Sheet Arrangements

We were not involved in any significant off-balance sheet arrangement during the three months ended January 31, 2010.

#### Critical Accounting Policies and Estimates

There were no material changes during the three months ended January 31, 2010 to the critical accounting policies reported in our Annual Report on Form 10-K for the fiscal year ended October 31, 2009.

#### New Accounting Pronouncements

There were no new accounting standards, issued since our filing of the Annual Report on Form 10-K for the fiscal year ended October 31, 2009, which could have a significant effect on our condensed consolidated financial statements.

#### Forward-Looking Statements

Our business, financial condition, results of operations, cash flows and prospects, and the prevailing market price and performance of our common stock, may be adversely affected by a number of factors, including the matters discussed below. Certain statements and information set forth in this Quarterly Report on Form 10-Q, as well as other written or oral statements made from time to time by us or by our authorized executive officers on our behalf, constitute “forward-looking statements” within the meaning of the Federal Private Securities Litigation Reform Act of 1995. These



statements include all statements other than those made solely with respect to historical fact and identified by words such as “believes”, “anticipates”, “expects”, “intends” and similar expressions, but such words are not the exclusive means of identifying such statements. We intend for our forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we set forth this statement and these risk factors in order to comply with such safe harbor provisions. You should note that our forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q or when made and we undertake no duty or obligation to update or revise our forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the expectations, plans, intentions and projections reflected in our forward-looking statements are reasonable, such statements are subject to 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 the forward-looking statements. The risks, uncertainties and other factors that our stockholders and prospective investors should consider include the following:

-15-

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- Because our business is concentrated in the pharmaceutical industry in Puerto Rico, any changes in that industry could impair our ability to generate revenue and realize a profit.
- Because our business is dependent upon a small number of clients, the loss of a major client could impair our ability to operate profitably.
- Customer procurement and sourcing practices intended to reduce costs could have an adverse affect on our margins and profitability.
- Since our business is dependent upon the development and enhancement of patented pharmaceutical products or processes by our clients, the failure of our clients to obtain and maintain patents could impair our ability to operate profitably.
- We may be unable to pass on increased labor costs to our clients.
- Consolidation in the pharmaceutical industry may have a harmful effect on our business.
- Because the pharmaceutical industry is subject to government regulations, changes in government regulations relating to this industry may affect the need for our services.
- Changes in tax benefits may affect the willingness of companies to continue or expand their operations where we do business.
- Puerto Rico's economy, including its governmental financial crisis, may affect the willingness of businesses to commence or expand operations in Puerto Rico.
- Other factors, including economic factors, may affect the decision of businesses to continue or expand their operations in Puerto Rico.
- If we are unable to protect our clients' intellectual property, our ability to generate business will be impaired.
- We may be subject to liability if our services or solutions for our clients infringe upon the intellectual property rights of others.
- We may be held liable for the actions of our employees or contractors when on assignment.
- To the extent that we perform services pursuant to fixed-price or incentive-based contracts, our cost of services may exceed our revenue on the contract.
- Because most of our contracts may be terminated on little or no advance notice, our failure to generate new business could impair our ability to operate profitably.
- Because we are dependent upon our management, our ability to develop our business may be impaired if we are not able to engage skilled personnel.
- We may not be able to continue to grow unless we consummate acquisitions or enter markets outside of Puerto Rico.
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If we identify a proposed acquisition, we may require substantial cash to fund the cost of the acquisition.

- If we make any acquisitions, they may disrupt or have a negative impact on our business.
- Because there is a limited market in our common stock, stockholders may have difficulty in selling our common stock and our common stock may be subject to significant price swings.
- Our quarterly revenues, operating results and profitability will vary from quarter to quarter, which may result in increased volatility of our stock price.
- The issuance of securities, whether in connection with an acquisition or otherwise, may result in significant dilution to our stockholders.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

Changes in Internal Control Over Financial Reporting

Based on an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, there has been no change in our internal control over financial reporting during our last fiscal quarter identified in connection with that evaluation that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

-17-

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PART II- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may be a party to legal proceedings incidental to our business. We do not believe that there are any proceedings threatened or pending against us, which, if determined adversely to us, would have a material effect on our financial position or results of operations and cash flows.

ITEM 6. EXHIBITS

(a) Exhibits:

10.1 Employment Agreement Amendment, effective as of January 1, 2010, by and between the Company and Elizabeth Plaza (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on January 7, 2010).

10.2 Employment Agreement Amendment, effective as of January 1, 2010, by and between the Company and Pedro Lasanta (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on January 7, 2010).

10.3 Employment Agreement, dated as of December 31, 2009, by and between Pharma-Bio Serv PR, Inc. and Nelida Plaza (incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed on January 7, 2010).

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 the chief executive officer and chief financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

PHARMA-BIO SERV, INC.

/s/ Elizabeth Plaza  
Elizabeth Plaza  
Chief Executive Officer  
(Principal Executive Officer)

/s/ Pedro J. Lasanta  
Pedro J. Lasanta  
Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)

Dated: March 17, 2010