

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

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

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended July 31, 2008

- 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.

Yes  No

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

Yes  No

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

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**PHARMA-BIO SERV, INC.**

**FORM 10-QSB**

**FOR THE QUARTER ENDED JULY 31, 2008**

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

|   |              |
|---|--------------|
| <b>ASSETS:</b>  |              |
| 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  |              |
| Other assets, mainly intangible assets  | 1,555,205    |
|   | 80,625       |
| Total assets  | \$ 8,176,588 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>  |              |
| 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<br>10,000,000 shares; none outstanding                      | -            |
| Common Stock, \$0.0001 par value; authorized 50,000,000<br>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, |              | Nine months ended July 31, |               |
|---|-----------------------------|--------------|----------------------------|---------------|
|   | 2008                        | 2007         | 2008                       | 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<br>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<br>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  |
| <br>  |                             |              |                            |               |
| BASIC EARNINGS PER COMMON<br>SHARE                                      | \$ 0.03                     | \$ 0.04      | \$ 0.06                    | \$ 0.08       |
| DILUTED EARNINGS PER<br>COMMON SHARE                                    | \$ 0.02                     | \$ 0.03      | \$ 0.05                    | \$ 0.07       |
| <br>  |                             |              |                            |               |
| WEIGHTED AVERAGE NUMBER<br>OF COMMON<br>SHARES OUTSTANDING –<br>BASIC   | 19,892,186                  | 19,615,539   | 19,708,428                 | 19,315,415    |
| <br>  |                             |              |                            |               |
| WEIGHTED AVERAGE NUMBER<br>OF COMMON<br>SHARES OUTSTANDING –<br>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**

|   | <b>Three months ended July 31,</b> |                     | <b>Nine months ended July 31,</b> |                     |
|---|------------------------------------|---------------------|-----------------------------------|---------------------|
|   | <b>2008</b>                        | <b>2007</b>         | <b>2008</b>                       | <b>2007</b>         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                    |                     |                                   |                     |
| 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             |
| <b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>                        | <b>(482,320)</b>                   | <b>11,455</b>       | <b>558,434</b>                    | <b>3,833,079</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                    |                     |                                   |                     |
| Acquisition of property and equipment   | (41,128)                           | (22,090)            | (742,598)                         | (40,170)            |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                      | <b>(41,128)</b>                    | <b>(22,090)</b>     | <b>(742,598)</b>                  | <b>(40,170)</b>     |
| <b>CASH FLOW FROM FINANCING ACTIVITIES:</b>                                       |                                    |                     |                                   |                     |
| 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)         |
| <b>NET CASH PROVIDED BY (USED IN) IN FINANCING ACTIVITIES</b>                     | <b>370,857</b>                     | <b>(9,815)</b>      | <b>(2,401,125)</b>                | <b>(2,778,863)</b>  |
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>                       | <b>(152,591)</b>                   | <b>(20,450)</b>     | <b>(2,585,289)</b>                | <b>1,014,046</b>    |
| <b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>                            | <b>2,359,668</b>                   | <b>3,309,531</b>    | <b>4,792,366</b>                  | <b>2,275,035</b>    |
| <b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>                                  | <b>\$ 2,207,077</b>                | <b>\$ 3,289,081</b> | <b>\$ 2,207,077</b>               | <b>\$ 3,289,081</b> |

SUPPLEMENTAL DISCLOSURESOFCASH 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 SCHEDULESOF NON-CASH INVESTING ANDFINANCING 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<br>Stock Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total        |
|---|--------------|----------|-----------------|--------|--|----------------------|---|--------------|
|   | Shares       | Amount   | Shares          | Amount |  |                      |   |              |
| BALANCE AT<br>OCTOBER 31, 2007                            | 19,615,539   | \$ 1,961 | -               | \$ -   | \$ 115,404                             | \$ 2,046,264         | \$ 3,554  | \$ 2,167,183 |
| CONVERSION OF<br>WARRANTS TO<br>SHARES OF COMMON<br>STOCK | 1,135,676    | 114      | -               | -      | 382,747                                | -                    | -   | 382,861      |
| STOCK-BASED<br>COMPENSATION                               | -            | -        | -               | -      | 116,972                                | -                    | -   | 116,972      |
| COMPREHENSIVE<br>INCOME:                                  |              |          |                 |        |  |                      |   |              |
| NET INCOME  | -            | -        | -               | -      | -                                      | 1,142,785            | -   | 1,142,785    |
| OTHER<br>COMPREHENSIVE<br>LOSS:                           |              |          |                 |        |  |                      |   |              |
| FOREIGN CURRENCY<br>TRANSLATION<br>ADJUSTMENT             | -            | -        | -               | -      | -                                      | -                    | (12,508)  | (12,508)     |
| OTHER<br>COMPREHENSIVE<br>LOSS                            |              |          |                 |        |  |                      |   | (12,508)     |
| COMPREHENSIVE<br>INCOME                                   |              |          |                 |        |  |                      |   | 1,130,277    |
| BALANCE AT JULY 31,<br>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.



## **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.

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## **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 these are incurred. SFAS 141R also requires additional disclosures of information surrounding a business combination. The provisions of SFAS 141R are effective for fiscal years beginning on or after December 15, 2008 and apply to business combinations that are completed on or after the date of adoption. The Company has not yet adopted this pronouncement, but expects that the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions the Company completes after the effective date, if any.

2. In December 2007, the FASB issued Statement No. 160 "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51". This Statement applies to all entities that prepare consolidated financial statements, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited.

Management does not expect that the application of this standard will have any significant effect on the Company's consolidated financial statements.

3. In February 2007, the FASB issued Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115". This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, "Fair Value Measurements".

Management does not expect that the application of this standard will have any significant effect on the Company's consolidated financial statements.

4. In September 2006, the FASB issued Statement No. 157 "Fair Value Measurement". This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. The provisions of this Statement should be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except for certain exceptions stated in the Statement.

The implementation of this Statement had no significant effect on the Company's consolidated financial statements.



5. In June 2006, the FASB issued Interpretation No. 48 “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109” (“FIN 48”). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The application of this standard had no significant effect on the Company's results of operations or its financial condition.

6. Other recently issued FASB Statements or Interpretations, SEC Staff Accounting Bulletins, and AICPA Emerging Issue Task Force Consensuses have either been implemented or are not applicable to the Company.

### NOTE C - PROPERTY AND EQUIPMENT

The balance of property and equipment at July 31, 2008 consists of the following:

|   | Useful life (years) | Amount       |
|---|---------------------|--------------|
| Vehicles under capital leases                   | 5                   | \$ 255,129   |
| Leasehold improvements                          | 5                   | 19,279       |
| Computers                                       | 3                   | 217,366      |
| Equipment                                       | 3-5                 | 121,622      |
| Furniture and fixtures                          | 10                  | 68,509       |
| Projects in progress                            | -                   | 1,301,478    |
| Total   |                     | 1,983,383    |
| Less: Accumulated depreciation and amortization |                     | (428,178)    |
| Property and equipment, net                     |                     | \$ 1,555,205 |

### NOTE D - OTHER ASSETS

At July 31, 2008, non-current other assets include the following:

|  |           |
|--|-----------|
| Intangible assets:   |           |
| Covenant not to compete, net of accumulated amortization of \$53,333       | \$ 46,667 |
| Customer-related intangibles, net of accumulated amortization of \$129,167 | 20,833    |
| Other assets   | 13,125    |
|  | \$ 80,625 |

Covenant not to compete represents the portion of the payment made in connection with the purchase of the Pharma-PR stock that was allocated to a non-competition covenant. Under this agreement, the then sole stockholder of Pharma-PR agreed not to compete with the Company for a period of five years. This amount is amortized on the straight-line method over the five-year term of the non-competition covenant.

Customer-related intangible assets consist mainly of a customer list which Pharma-PR acquired along with other assets from a business which performs in the United States consulting services similar to those performed by the Company in Puerto Rico. The value of the customer list is being amortized on the straight-line method over its estimated useful life of three years.

Intangible assets amortization expense for each of the three-month periods ended on July 31, 2008 and 2007 amounted to \$17,500, and for each of the nine-month periods ended July 31, 2008 and 2007 amounted to \$52,500.



**NOTE E - LINE-OF-CREDIT**

The Company has available an unsecured line-of-credit with a financial institution, which provides for borrowings up to \$250,000. This line of credit may be used as working capital whenever the Company's bank account cannot meet its daily cash requirements. Interest on advances obtained from this line-of-credit will be paid at 2% over the bank's prevailing prime rate. At no time during the nine-month period ended July 31, 2008 was the line-of-credit used.

**NOTE F - INCOME TAXES**

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 new microbiological 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%.

For fiscal year 2008 Pharma-PR operations not covered in the exempt activities of the Grant are subject to the Puerto Rico income tax at a maximum tax rate of 39% as provided by the 1994 Puerto Rico Internal Revenue Code, as amended. However, for the year ended October 31, 2007, the Company was subject to an additional 2.5% special tax as imposed to corporations and partnerships by Puerto Rico Act No. 41 of August 2005, as amended by Act No. 244 of November 2006.

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.

As of July 31, 2008, the Company has not recognized deferred income taxes on \$3,393,976 of 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 \$339,397 tollgate tax.

The reasons for the difference between the provision for income tax applicable to income before provision for income taxes and the amount computed by applying the applicable statutory tax rate in Puerto Rico were as follows:

|   | <b>Three months ended July 31,</b> |             | <b>Nine months ended July 31,</b> |              |
|---|------------------------------------|-------------|-----------------------------------|--------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                       | <b>2007</b>  |
| Theoretical income tax expense by application of statutory rates to the book pre-tax income | \$ 275,529                         | \$ 498,941  | \$ 768,807                        | \$ 1,117,054 |
| Permanent differences, net  | 16,102                             | 8,799       | 37,767                            | 32,386       |

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|                    |    |         |    |         |    |         |    |           |
|--------------------|----|---------|----|---------|----|---------|----|-----------|
| Income tax expense | \$ | 291,631 | \$ | 507,740 | \$ | 806,574 | \$ | 1,149,440 |
|--------------------|----|---------|----|---------|----|---------|----|-----------|

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**NOTE G - 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. As of July 31, 2008 two installments were paid.

Outstanding installment as of July 31, 2008:

|   |              |
|---|--------------|
| Installment due January 25, 2009                      | \$ 2,750,000 |
| Less: imputed interest                                | (88,469)     |
| Present value of minimum payment, due within one year | \$ 2,661,531 |

**NOTE H - LEASE COMMITMENTS**

**Capitalized lease obligations** - As of July 31, 2008, the Company leases vehicles under non-cancelable capital leases with a cost of \$255,129 (accumulated depreciation of \$147,732). Amortization expense for these assets amounted to \$12,757 and \$11,072 in the three-month periods ended July 31, 2008 and 2007, respectively, and \$36,585 and \$33,216 in the nine-month periods ended July 31, 2008 and 2007, respectively. The following is a schedule, by year, of future minimum lease payments under the capitalized leases together with the present value of the net minimum lease payments at July 31, 2008:

| <b>Twelve months ending July 31,</b>               | <b>Amount</b> |
|--|---------------|
| 2009   | \$ 56,294     |
| 2010   | 72,175        |
| 2011   | 11,232        |
| 2012   | 8,054         |
| 2013   | 4,028         |
| Total future minimum lease payments                | 151,783       |
| Less: Amount of imputed interest                   | ( 10,426)     |
| Present value of future minimum lease payments     | 141,357       |
| Current portion of obligation under capital leases | (50,285)      |
| Long-term portion                                  | \$ 91,072     |

**Operating facilities** - The Company conducts its administrative operations in office facilities which are leased under three different rental agreements.

In February 2007, the Company entered into a lease agreement with an affiliate of the chief executive officer for the new headquarters and laboratory testing facilities in Dorado, Puerto Rico. The lease agreement is for a term of five years with monthly rental payments of \$18,750, \$19,687, \$20,672, \$21,705 and \$22,791 for each of the years under the lease. The lease agreement ends in January 2012 and provides a five year-renewal option. The agreement also requires the payment of utilities, property taxes, insurance and a portion of expenses incurred by the affiliate in connection with the maintenance of common areas. Through January 2007, a different smaller facility was leased from the same entity.

In August 2007, the Company renewed its lease agreement for office facilities in Limerick, Pennsylvania. The lease agreement was renewed for a term of three years with monthly rental payments of \$1,050, \$1,100, and \$1,150; for each of the years under the lease which ends in July 2010.

The Company maintains office facilities in Cork, Ireland. The facilities are under a month-to-month lease with monthly payments of approximately \$750.

The Company leases certain apartments as dwellings for employees. The leases are under short-term lease agreements and usually are cancelable upon 30-day notification.

Minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year as of July 31, 2008 are:

|                                     | <b>Amount</b>     |
|-------------------------------------|-------------------|
| 2009                                | \$ 255,356        |
| 2010                                | 268,064           |
| 2011                                | 266,977           |
| 2012                                | 136,744           |
| <b>Total minimum lease payments</b> | <b>\$ 927,141</b> |

Rent expense during the three-month periods ended July 31, 2008 and 2007 was \$114,652 and \$69,807, respectively, and \$303,900 and \$158,870 for the nine-month periods ended July 31, 2008 and 2007, respectively.

## **NOTE I - STOCK OPTIONS AND STOCK BASED COMPENSATION**

In October 2005, the Company's board of directors adopted, and on April 25, 2006, the Company's stockholders approved, the 2005 Long-Term Incentive Plan, covering 2,500,000 shares of common stock. The 2005 plan provides for the grant of incentive and non-qualified options, stock grants, stock appreciation rights and other equity-based incentives to employees, including officers, consultants and directors. The 2005 plan is to be administered by a committee of independent directors. In the absence of a committee, the plan is administered by the board of directors. Options intended to be incentive stock options must be granted at an exercise price per share which is not less than the fair market value of the common stock on the date of grant and may have a term which is not longer than ten years. If the option holder holds at least 10% of the Company's common stock, the exercise price must be at least 110% of the fair market value on the date of grant and the term of the option cannot exceed five years.

Effective November 1, 2006, the Company adopted the provisions of SFAS No.123R, "Share-Based Payment" ("SFAS 123R"), and S.E.C. Staff Accounting Bulletin No. 107 ("SAB 107"). The Company recognizes stock-based compensation 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 following table presents the stock-based compensation included in the Company's consolidated statement of income:

|                                      | Three months ended July 31, |           | Nine months ended July 31, |           |
|--------------------------------------|-----------------------------|-----------|----------------------------|-----------|
|                                      | 2008                        | 2007      | 2008                       | 2007      |
| Stock-based compensation expense:    |                             |           |                            |           |
| Cost of services                     | \$ 15,397                   | \$ 9,824  | \$ 45,985                  | \$ 51,914 |
| Selling, general and administrative  | 26,556                      | 16,713    | 70,987                     | 39,997    |
| Stock-based compensation before tax  | 41,953                      | 26,537    | 116,972                    | 91,911    |
| Income tax benefit                   | -                           | -         | -                          | -         |
| Net stock-based compensation expense | \$ 41,953                   | \$ 26,537 | \$ 116,972                 | \$ 91,911 |

During the nine-month period ended in July 31, 2008, in accordance with the 2005 Long-Term Incentive Plan, the Company awarded stock options to certain employees, executives and directors to purchase an aggregate of 370,000 shares of common stock.

#### NOTE J – WARRANTS

At July 31, 2008 the Company had outstanding warrants to purchase 11,053,216 shares of the Company's common stock 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.

Warrants for the purchase of 466,667 and 669,009 common shares with exercise prices of \$0.7344 and \$0.06, respectively, were exercised by two warrant holders in July 2008. Proceeds in excess of the common shares' par value were recorded in the accounting records as Additional Paid-in Capital.

#### NOTE K – EARNINGS PER SHARE

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

|  | Three months ended July 31, |            | Nine months ended July 31, |              |
|--|-----------------------------|------------|----------------------------|--------------|
|  | 2008                        | 2007       | 2008                       | 2007         |
| Net income available to common equity holders - used to compute basic and diluted earnings per share | \$ 514,878                  | \$ 694,528 | \$ 1,142,785               | \$ 1,542,256 |
| Weighted average number of common shares - used to compute basic earnings per share                  | 19,892,186                  | 19,615,539 | 19,708,428                 | 19,315,415   |
| Effect of warrants to purchase common stock  | 2,318,630                   | 2,452,346  | 2,444,831                  | 2,777,433    |
| Effect of options to purchase common stock   | -                           | -          | -                          | -            |
| Weighted average number of shares - used to compute diluted earnings per share                       | 22,210,816                  | 22,067,885 | 22,153,259                 | 22,092,848   |

Warrants for the purchase of 8,972,625 and 9,439,292 shares of common stock for the three-month and nine-month periods ended in July 31, 2008 and 2007, respectively, were not included in computing diluted earnings per share

because, their effects were antidilutive. In addition, options for the purchase of 1,506,772 shares of common stock for the three and nine months periods ended in July 31, 2008, and 1,413,090 shares of stock for the three and nine months periods ended in July 31, 2007, were not included in computing diluted earnings per share because their effects were also antidilutive.

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## **NOTE L - CONCENTRATION OF RISKS**

### **Cash and cash equivalents**

The Company maintains cash deposits in a 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. The money market fund is not insured. No losses have been experienced or are expected on these accounts.

### **Accounts receivable and revenues**

Management deems all 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 few customers represent a significant source of revenue, our functions are not a continuous process, accordingly, the client base for which our services are typically rendered, on a project-by-project basis, changes regularly.

The Company provides a substantial portion of its services to three customers, which accounted for 10% or more of its revenues in either the three-month and nine month periods ended July 31, 2008 or 2007. During the three-month period ended July 31, 2008 revenues from these customers were 31%, 28% and 0%, or a total of 59%, as compared to the same period last year for 16%, 28% and 22%, or a total of 66%, respectively. For the nine-month period ended July 31, 2008 revenues from these customers were 29%, 27% and 0%, or a total of 56%, as compared to the same period last year for 8%, 27% and 27%, or a total of 62%, respectively. At July 31, 2008 amounts due from these customers represented 54% of total accounts receivable balance.

## **NOTE M - RETIREMENT PLAN**

Pharma-PR has a qualified profit sharing plan in accordance with the provision of Section 1165(a)(3)(A) of the Puerto Rico Code, for employees who meet certain age and service period requirements. The Company makes contributions to this plan as required by the provisions of the plan document. Contributions for the three-month periods ended July 31, 2008 and 2007 were \$15,340 and \$18,760, respectively, and \$45,970 and \$47,314 for the nine-month period ended July 31, 2008 and 2007, respectively.

## Item 2. Management's Discussion and Analysis

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. 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-KSB for the year ended October 31, 2007. 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.

### Overview

We are a validation and compliance consulting service firm with headquarters in Puerto Rico, servicing the Puerto Rico, the United States and Europe markets. The validation and compliance consulting service market in those markets consists of local validation and compliance 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 and validation consulting services. 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 145 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.

Our revenue is derived from time and materials contracts (representing approximately 90% of total revenues), where the clients are charged for the time, materials and expenses incurred on a particular project, and to a lesser extent (approximately 10% of total revenues) from fixed-fee contracts or from "not to exceed" contracts, which are generally short-term contracts, in which the value of the contract cannot exceed a stated amount. For time and materials contracts, our revenue is principally a function of the number of compliance and validation professionals and the number of hours billed per professional. To the extent that our revenue is based on fixed-fee or "not to exceed" contracts, our ability to operate profitably is dependent upon our ability to estimate accurately the costs that we will incur on a project and to the management and monitoring of the project progress. If we underestimate our costs on any contract, we could sustain a loss on the contract or its profitability might be reduced.

We believe the most significant factors to achieving future business growth are our ability to (a) continue to provide quality value-added validation and compliance services to our clients; (b) recruit and retain highly educated and experienced validation and compliance professionals; (c) further expand our products and services to address the expanding compliance needs of the clients; and (d) expand our market presence into the United States, Europe and possibly other emerging pharmaceutical markets, in order to respond to the international validation and compliance demands of our clients. Since our business is conducted mainly in Puerto Rico, our business may be affected to the extent that the Puerto Rico's current economic problems affect the decision of our customers and potential customers to locate in Puerto Rico or to continue or expand their existing operations.

On July 1, 2008 the Company received certification as a "minority-controlled company" as defined by the National Minority Supplier Development Council and Growth Initiative ("NMSDC"). In line with the strategy to penetrate the United States market, the certification will allow the Company 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, 2009.

We have a well-established and consistent relationship with the major pharmaceutical, biotechnology, medical device and chemical manufacturing companies in Puerto Rico and United States, which provides us access to affiliated companies in other markets. We see opportunities in markets that could yield profitable margins using our professional consulting force and also provide new services such as those performed by our new microbiological testing laboratory facility.

As part of our growth strategy and our plans to enter new markets, we have invested in our infrastructure to support our expansion plans. This investment includes facilities, systems and, the strengthening of our executive staff to support our new laboratory facility, our market expansions in the United States, and most recently, Europe. In addition, by the end of fiscal year 2008 we will invest a total of approximately \$1.4 million in equipment and improvements for a new microbiological testing laboratory ("the Lab"). As of July 31, 2008, we have invested approximately \$1.3 million and have budgeted the balance for the remaining of our fiscal year 2008. Our new Lab facility incorporates the latest technology and test methodologies meeting pharmacopoeia industry standards and regulations. We offer microbiological testing and related services to our core industries already serviced as well as the cosmetic and food industries. During the quarter ended July 31 2008, as part of the development of the Lab, the Lab has been subject to audits by potential customers. These audits are part of the industry vendor certification process standards for quality related services.

Recently, some of our clients, mostly triggered by worldwide operations consolidation, have reduced or discontinued some or all of their Puerto Rico operations. Our strategy to penetrate the United States market has been successful in gaining new customers and revenues, and has also partially offset the Puerto Rico market decline in revenues in the nine months ended July 31, 2008 by approximately \$1.8 million, for a total net revenue decrease in that period of approximately \$0.8 million. In order to maintain volume in the Puerto Rico market we are constantly ensuring that we are price competitive and have adjusted our pricing and gross margin structure accordingly. In addition, we have implemented cost containment measures, refocused our Puerto Rico operations strategy and reduce its overhead costs.

Our client base, for which our services are typically rendered, on a project-by-project basis, changes regularly. Therefore, in any given year a small number of customers could represent a significant source of our revenue for that year. For the nine-month periods ended July 31, 2008 and 2007, three customers accounted for approximately 59% and 55% of revenue, respectively. The loss of or significant reduction in the scope of work performed for any major customer or our inability to replace customers upon completion of contracts could adversely affect our revenue and impair our ability to operate profitably.

Although our business is affected by seasonal factors such as vacation and holiday work policies, we do not believe that our business is seasonal. However, because our business is based on performing services under contracts that relate to specific projects, there may be a lag between the completion of one project and the commencement of the following project. This lag may cause some decline in revenues and a related decline in gross margin.

The principal components of our costs of services are employee compensation (salaries, wages, taxes and benefits) and expenses relating to the performance of the services. In order to ensure that our pricing is competitive yet minimize the impact in our margins, we deal with increasing labor costs by (i) selecting resources according to our cost for specific projects, (ii) negotiate, where applicable, rates with the resource, (iii) subcontract labor and, (iv) negotiate and pass rate increases to our customers, as applicable. Although this strategy has been successful in the past, we cannot give any assurance that we will continue to be able to do so.

The following table sets forth information as to our revenue for the three-month and nine-month periods ended July 31, 2008, by geographic regions (dollars in thousands).

|                           | Three months<br>ended July 31, 2008 |         | Nine months<br>ended July 31, 2008 |         |
|---------------------------|-------------------------------------|---------|------------------------------------|---------|
|                           | Revenues                            | Percent | Revenues                           | Percent |
| <b>Revenues by Region</b> |                                     |         |                                    |         |
| <b>Puerto Rico</b>        | \$ 2,888                            | 68.9%   | \$ 8,173                           | 71.1%   |
| <b>United States</b>      | 1,218                               | 29.0%   | 3,209                              | 27.9%   |
| <b>Ireland</b>            | 86                                  | 2.1%    | 112                                | 1.0%    |
|                           | \$ 4,192                            |         | \$ 11,494                          |         |

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 new microbiological 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%. For the nine months ended in July 31, 2008 the Grant represented savings of approximately \$40,000 on income taxes mostly related to the Company’s activities rendered from Puerto Rico to the US market. In May 28, 2008 a new tax incentive law (“Act No. 73”) was enacted in Puerto Rico. The Company is considering whether to convert the Grant to the provisions of Act No. 73. If converted and granted, the Company might enjoy additional exemptions of various taxes and certain tax credits.

### Critical Accounting Policies and Estimates

There were no material changes during the nine months ended July 31, 2008 to the critical accounting policies reported in our Annual Report on Form 10-KSB for the fiscal year ended October 31, 2007.

## Results of Operations

The following table sets forth our statements of operations for the three-month and nine-month periods ended July 31, 2008 and 2007, (dollars in thousands) and as a percentage of revenue:

|  | Three months ended<br>July 31, |        |          |        | Nine months ended<br>July 31, |        |           |        |
|--|--------------------------------|--------|----------|--------|-------------------------------|--------|-----------|--------|
|  | 2008                           |        | 2007     |        | 2008                          |        | 2007      |        |
| Revenues                                     | \$ 4,192                       | 100.0% | \$ 4,540 | 100.0% | \$ 11,494                     | 100.0% | \$ 12,296 | 100.0% |
| Cost of services                             | 2,548                          | 60.8%  | 2,512    | 55.3%  | 7,130                         | 62.0%  | 7,108     | 57.8%  |
| Gross profit                                 | 1,644                          | 39.2%  | 2,028    | 44.7%  | 4,364                         | 38.0%  | 5,188     | 42.2%  |
| Selling, general and<br>administrative costs | 802                            | 19.1%  | 762      | 16.8%  | 2,304                         | 20.0%  | 2,236     | 18.2%  |
| Interest expense                             | 46                             | 1.1%   | 88       | 1.9%   | 180                           | 1.6%   | 302       | 2.5%   |
| Interest income                              | 11                             | -0.3%  | 24       | -0.5%  | 69                            | -0.6%  | 68        | -0.6%  |
| Loss on disposition of<br>property           | -                              | 0.0%   | -        | 0.0%   | -                             | 0.0%   | 26        | 0.2%   |
| Income before income<br>taxes                | 807                            | 19.3%  | 1,202    | 26.5%  | 1,949                         | 17.0%  | 2,692     | 21.9%  |
| Income tax expense                           | 292                            | 7.0%   | 508      | 11.2%  | 806                           | 7.0%   | 1,150     | 9.4%   |
| Net income                                   | 515                            | 12.3%  | 694      | 15.3%  | 1,143                         | 10.0%  | 1,542     | 12.5%  |

**Revenues.** Revenues for the quarter ended July 31, 2008 were \$4.2 million, a net decrease of approximately \$0.3 million or 7.7%, when compared to the same quarter last year. The reduction is mainly attributable to the decrease of approximately \$0.8 million in the Puerto Rico market service revenue, partially offset by gains in the United States market of approximately \$0.4 million and \$0.1 million generated by the Ireland operation.

For the nine-month period ended July 31, 2008 service revenues were \$11.5 million, a net decrease of approximately \$0.8 million or 6.5% from the comparable nine-month period last year. The decrease in Puerto Rico market service revenues by approximately \$2.7 million was partially offset by gains in the United States market of approximately \$1.8 million and \$0.1 million generated by the Ireland operation.

Service revenue gains in the United States market are attributable to the company's strategy to enter in new markets. This strategy has partially offset the service revenue loss sustained in the Puerto Rico market. Decreases in the Puerto Rico market service revenue are mostly due to the closing of, or decrease in, operations of some pharmaceutical plants located in Puerto Rico, triggered by operations consolidation.

**Cost of Services: gross margin.** The gross margin decreased by 5.5 and 4.2 percent points in the three-month and nine-month periods ending July 31, 2008, respectively, when compared to the same periods last year. The net gross margin reduction is mainly attributable to our strategy to maintain volume in the Puerto Rico market by keeping its pricing competitiveness.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses were approximately \$802,000 and \$2,304,000 for the three-month and nine-month periods ended in July 31, 2008, respectively. These expenses represent a net increase of approximately \$40,000 and \$68,000 for the three-month and nine-month periods ended in July 31, 2008, respectively, as compared to the same periods last year. The net increase in expenses is mainly attributable to the new Ireland operation which incurred expenses for approximately \$59,000 and \$191,000 for the three and nine months periods ended in July 31, 2008, respectively, which were partially offset by expense containment measures implemented during the current fiscal year, geared to offset the Puerto Rico market revenue decline.



Interest Expense. We have been recognizing 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 expense decreases as annual payments are made. The last installment under the plan and agreement of merger is due January 25, 2009.

Income Taxes Expense. For the current fiscal year we are no longer subject to a 2.5% additional special tax imposed by the Puerto Rico Act No. 41 of August 1, 2005. Therefore, for fiscal year 2008 our statutory tax rate in Puerto Rico has decreased to 39% from 41.5% last year. In addition, with the recently granted tax exemption the Company benefited by approximately \$40,000 in income tax savings. The decrease on income taxes expense is attributable to this factor and the decrease of income before income tax.

Net Income. Our net income for the three-month and nine-month periods ended in July 31, 2008 were approximately \$515,000 and \$1,143,000, respectively, a decline to last year comparable periods for approximately \$179,000 and \$399,000, respectively, or 26% for both periods.

For the three-month period ended in July 31, 2008 earnings per common share basic and diluted were \$0.03 and \$0.02, respectively, a decline in each of them of \$0.01 to last year same period. For the nine-month period ended in July 31, 2008 earnings per common share basic and diluted were \$0.06 and \$0.05, respectively, both declined by \$0.02 when compared to the same period last year.

Our net income was affected by the decrease in gross margin, expenses related to our new Ireland operation, partially offset by cost containment measures in selling, general and administrative expenses, favorable variances in interest expense, interest income and statutory tax rate.

### **Liquidity and Capital Resources**

Liquidity is a measure of our ability to meet potential cash requirements, including planned capital expenditures. For the nine months ended July 31, 2008 we have generated cash flow from operations of approximately \$558,000 and working capital of approximately \$2.2 million, notwithstanding within the same period we have invested in a laboratory facility approximately \$ 1 million, and have made a payment of \$2.75 million pursuant the 2006 Pharma-PR acquisition agreement. Under the agreement, a final payment of \$2.75 million is due on January 25, 2009.

We are pursuing possible opportunities of expanding our operations beyond Puerto Rico, and in furtherance of this plan, we have set up facilities in Ireland to offer our services to companies in the pharmaceutical and related industries in Ireland. To the extent that we are able 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.

Our primary cash needs consist of payment of compensation to our professional staff, overhead expenses, statutory taxes, and payments pursuant to the agreement terms for the acquisition of Pharma-PR.

Management believes that based on current levels 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, including our obligations to pay the final installment due pursuant to the agreement relating to the acquisition of Pharma-PR, for the next twelve months.

While uncertainties relating to 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.



## Forward Looking Statements

This Report on Form 10-QSB contains certain forward-looking statements that are based on current expectations. In light of the important factors that can materially affect results, including those set forth in this paragraph and below, the inclusion of forward-looking information herein should not be regarded as a representation by the Company or any other person that the objectives or plans of the Company will be achieved. The Company may be unable to expand its customer base or to replace customers upon the completion of contracts, and may encounter competitive, technological, financial and business challenges making it more difficult than expected to continue to develop and market its services. Our ability to generate profits may be adversely affected if the market does not accept the Company's existing and future services. In addition, our ability to generate profits may be adversely affected by changes relating to the business of our clients, tax, economic, industry trends and other factors relating to Puerto Rico and other markets in which we do business. If the Company is unable to retain existing key management personnel, such inability may have a significant negative effect on the Company. Further, other material adverse changes affecting our operations or business may have a significant negative effect on the Company. Assumptions relating to budgeting, marketing, and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our marketing and other budgets, which may in turn affect our financial position and results of operations. The reader is therefore cautioned not to place undue reliance on forward-looking statements contained herein, which speak solely as of the date of this Form 10-QSB, and the forward looking statements are qualified in their entirety by reference to the material contained in "Risk Factors" and "Management's Discussion and Analysis" contained in our Form 10-KSB for the year ended October 31, 2007 and in "Management's Discussion and Analysis" in this Form 10-QSB and in our other filings with the SEC. We assume no responsibility to update any forward-looking statements as a result of new information, future events, or otherwise.

## Item 3. Controls and Procedures

As of the end of the period covered by this report, our chief executive officer and chief financial officer evaluated the effectiveness of our disclosure controls and procedures. Based on their evaluation, the chief executive officer and chief financial officer concluded that our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e), were effective as of the end of the period covered by this quarterly report.

During the quarterly period covered by this report, there were no changes in the Company's internal controls over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**PART II. OTHER INFORMATION**

**Item 6. Exhibits**

(a) Exhibits:

- 3.1 Amendment No. 1 to the Bylaws of the Company (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on June 6, 2008)
- 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 pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the 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: September 15, 2008