

Pharma-Bio Serv, Inc.  
Form 10-Q  
September 14, 2018

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 July 31, 2018

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

Pharma-Bio Serv Building, 00646  
# 6 Road 696 (Zip Code)  
Dorado, Puerto Rico  
(Address of Principal Executive Offices)

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, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer    Accelerated filer  
Non-accelerated filer    Smaller reporting company  
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 September 7, 2018 was 23,062,531.



PHARMA-BIO SERV, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED JULY 31, 2018

TABLE OF CONTENTS

|  | Page |
|--|------|
| <b>PART I FINANCIAL INFORMATION</b>  |      |
| Item 1 – Financial Statements  |      |
| Condensed Consolidated Balance Sheets as of July 31, 2018 and October 31, 2017 (unaudited)   | 1    |
| Condensed Consolidated Statements of Operations for the three-month and nine-month periods ended July 31, 2018 and 2017 (unaudited)                  | 2    |
| Condensed Consolidated Statements of Comprehensive Income (Loss) for the three-month and nine-month periods ended July 31, 2018 and 2017 (unaudited) | 3    |
| Condensed Consolidated Statements of Cash Flows for the three-month and nine-month periods ended July 31, 2018 and 2017 (unaudited)                  | 4    |
| Notes to Condensed Consolidated Financial Statements (unaudited)   | 5    |
| Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations   | 13   |
| Item 4 – Controls and Procedures   | 18   |
| <b>PART II OTHER INFORMATION</b>   |      |
| Item 1 – Legal Proceedings   | 19   |
| Item 6 – Exhibits  | 19   |
| SIGNATURES   | 20   |



## PART I – FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## PHARMA-BIO SERV, INC.

Condensed Consolidated Balance Sheets  
(Unaudited)

|  | July 31,<br>2018* | October 31,<br>2017** |
|--|-------------------|-----------------------|
| <b>ASSETS</b>  |                   |                       |
| Current assets:  |                   |                       |
| Cash and cash equivalents  | \$15,188,876      | \$11,751,714          |
| Marketable securities  | 38,713            | 26,600                |
| Accounts receivable  | 5,179,579         | 7,208,054             |
| Other  | 488,919           | 550,163               |
| Total current assets   | 20,896,087        | 19,536,531            |
| Property and equipment   | 1,991,967         | 2,390,545             |
| Other assets   | 418,737           | 422,925               |
| Total assets   | \$23,306,791      | \$22,350,001          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                       |
| Current liabilities:   |                   |                       |
| Current portion-obligations under capital leases   | \$14,278          | \$13,949              |
| Accounts payable and accrued expenses  | 1,787,178         | 1,526,904             |
| Current portion of US Tax Reform Transition Tax and income taxes payable   | 252,903           | 2,067                 |
| Total current liabilities  | 2,054,359         | 1,542,920             |
| US Tax Reform Transition Tax payable   | 2,485,000         | -                     |
| Obligations under capital leases   | 49,506            | 59,795                |
| Total liabilities  | 4,588,865         | 1,602,715             |
| 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; 23,333,083 and 23,333,083 shares issued, and 23,062,531 and 23,089,631 shares outstanding, at July 31, 2018 and October 31, 2017, respectively | 2,333             | 2,333                 |
| Additional paid-in capital   | 1,347,964         | 1,295,314             |
| Retained earnings  | 17,498,402        | 19,560,131            |
| Accumulated other comprehensive income   | 131,049           | 137,671               |
|  | 18,979,748        | 20,995,449            |
| Treasury stock, at cost; 270,552 and 243,452 common shares held at July 31, 2018 and October 31, 2017, respectively  | (261,822)         | (248,163)             |

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|  |              |              |
|--|--------------|--------------|
| Total stockholders' equity                 | 18,717,926   | 20,747,286   |
| Total liabilities and stockholders' equity | \$23,306,791 | \$22,350,001 |

\* Unaudited.

\*\* Condensed from audited financial statements.

See notes to the condensed consolidated financial statements.

1





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

|  | Three months ended July 31, |             | Nine months ended July 31, |              |
|--|-----------------------------|-------------|----------------------------|--------------|
|  | 2018                        | 2017        | 2018                       | 2017         |
| REVENUES   | \$5,215,428                 | \$3,980,140 | \$13,832,217               | \$11,947,598 |
| COST OF SERVICES   | 3,607,236                   | 3,052,030   | 10,133,666                 | 8,945,953    |
| GROSS PROFIT   | 1,608,192                   | 928,110     | 3,698,551                  | 3,001,645    |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES                             | 1,239,957                   | 1,122,364   | 3,460,304                  | 3,904,464    |
| INCOME (LOSS) FROM OPERATIONS  | 368,235                     | (194,254)   | 238,247                    | (902,819)    |
| OTHER INCOME, NET  | 397,948                     | 32,622      | 436,599                    | 38,145       |
| INCOME (LOSS) BEFORE INCOME TAX AND US TAX REFORM TRANSITION TAX EXPENSE | 766,183                     | (161,632)   | 674,846                    | (864,674)    |
| INCOME TAX AND US TAX REFORM TRANSITION TAX EXPENSE                      | 35,552                      | 1,350       | 2,736,575                  | 3,206        |
| NET INCOME (LOSS)  | \$730,631                   | \$(162,982) | \$(2,061,729)              | \$(867,880)  |
| BASIC EARNINGS (LOSSES) PER COMMON SHARE                                 | \$0.032                     | \$(0.007)   | \$(0.089)                  | \$(0.038)    |
| DILUTED EARNINGS (LOSSES) PER COMMON SHARE                               | \$0.032                     | \$(0.007)   | \$(0.089)                  | \$(0.038)    |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC             | 23,062,531                  | 23,101,931  | 23,076,306                 | 23,090,207   |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED           | 23,074,606                  | 23,101,931  | 23,080,758                 | 23,094,105   |

See notes to the condensed consolidated financial statements.



PHARMA-BIO SERV, INC.

Condensed Consolidated Statements of Comprehensive Income (Loss)  
(Unaudited)

|  | Three months ended<br>July 31, |             | Nine months ended July<br>31, |             |
|--|--------------------------------|-------------|-------------------------------|-------------|
|  | 2018                           | 2017        | 2018                          | 2017        |
| NET INCOME (LOSS)  | \$730,631                      | \$(162,982) | \$(2,061,729)                 | \$(867,880) |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF<br>RECLASSIFICATION ADJUSTMENTS AND TAXES: |                                |             |                               |             |
| Foreign currency translation gain (loss)   | (54,292)                       | 28,822      | (18,735)                      | 33,179      |
| Net unrealized gain on available-for-sale-securities                                 | 2,494                          | 11,044      | 12,113                        | 11,067      |
| TOTAL OTHER COMPREHENSIVE INCOME (LOSS)  | (51,798)                       | 39,866      | (6,622)                       | 44,246      |
| COMPREHENSIVE INCOME (LOSS)  | \$678,833                      | \$(123,116) | \$(2,068,351)                 | \$(823,634) |

See notes to the condensed consolidated financial statements.



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

|  | Three months ended July 31, |                     | Nine months ended July 31, |                     |
|--|-----------------------------|---------------------|----------------------------|---------------------|
|  | 2018                        | 2017                | 2018                       | 2017                |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                             |                     |                            |                     |
| Net income (loss)  | \$730,631                   | \$(162,982)         | \$(2,061,729)              | \$(867,880)         |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                             |                     |                            |                     |
| Gain on disposition of vehicle   | -                           | (19,092)            | -                          | (19,092)            |
| Stock-based compensation   | 17,550                      | 19,775              | 52,650                     | 63,875              |
| Depreciation and amortization  | 153,736                     | 88,229              | 456,342                    | 298,335             |
| Decrease (increase) in accounts receivable   | 1,377,089                   | (311,759)           | 2,085,929                  | (51,053)            |
| Decrease (increase) in other assets  | (138,071)                   | (101,792)           | 68,224                     | 141,881             |
| Increase (decrease) in liabilities   | 104,015                     | 9,225               | 2,974,099                  | (768,298)           |
| <b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>   | <b>2,244,950</b>            | <b>(478,396)</b>    | <b>3,575,515</b>           | <b>(1,202,232)</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                             |                     |                            |                     |
| Acquisition of property and equipment  | -                           | (40,555)            | (57,764)                   | (364,647)           |
| Proceeds from disposition of vehicle   | -                           | 47,757              | -                          | 47,757              |
| <b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>   | <b>-</b>                    | <b>7,202</b>        | <b>(57,764)</b>            | <b>(316,890)</b>    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                             |                     |                            |                     |
| Repurchase of common stock   | -                           | -                   | (13,659)                   | (9,922)             |
| Payments on obligations under capital lease  | (3,347)                     | (42,502)            | (9,960)                    | (52,415)            |
| <b>NET CASH USED IN FINANCING ACTIVITIES</b>   | <b>(3,347)</b>              | <b>(42,502)</b>     | <b>(23,619)</b>            | <b>(62,337)</b>     |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>   | <b>(39,547)</b>             | <b>6,290</b>        | <b>(56,970)</b>            | <b>5,561</b>        |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>  | <b>2,202,056</b>            | <b>(507,406)</b>    | <b>3,437,162</b>           | <b>(1,575,898)</b>  |
| <b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>   | <b>12,986,820</b>           | <b>12,705,090</b>   | <b>11,751,714</b>          | <b>13,773,582</b>   |
| <b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>   | <b>\$15,188,876</b>         | <b>\$12,197,684</b> | <b>\$15,188,876</b>        | <b>\$12,197,684</b> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION</b>  |                             |                     |                            |                     |
| Cash paid during the period for:   |                             |                     |                            |                     |
| Income taxes   | \$-                         | \$-                 | \$-                        | \$65                |
| Interest   | \$519                       | \$527               | \$1,610                    | \$1,709             |
| <b>SUPPLEMENTARY SCHEDULES OF NON-CASH INVESTING AND FINANCING ACTIVITIES</b>                      |                             |                     |                            |                     |

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|  |         |          |          |           |
|--|---------|----------|----------|-----------|
| Obligations under capital lease incurred for the acquisition of a vehicle  | \$-     | \$77,470 | \$-      | \$77,470  |
| Income tax withheld by clients to be used as a credit in the Company's income tax return   | \$1,396 | \$1,202  | \$19,641 | \$21,803  |
| Conversion of cashless exercise of options to shares of common stock and shares issued under restricted stock unit agreements                          | \$-     | \$-      | \$-      | \$10      |
| Disposed property and equipment with accumulated depreciation of \$57,330 and \$87,364 for the three and nine months ended July 31, 2017, respectively | \$-     | \$85,995 | \$-      | \$116,029 |

See notes to the condensed consolidated financial statements.



PHARMA-BIO SERV, INC.

Notes To Condensed Consolidated Financial Statements

July 31, 2018

(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”) and Scienza Labs, Inc. (“Scienza Labs”), each a Puerto Rico corporation, Pharma-Bio Serv US, Inc. (“Pharma-US”), a Delaware corporation, Pharma-Bio Serv Validation & Compliance Limited (“Pharma-IR”), an Irish corporation, Pharma-Bio Serv SL (“Pharma-Spain”), a Spanish limited liability company, and Pharma-Bio Serv Brasil Servicos de Consultoria Ltda. (“Pharma-Brazil”), a Brazilian limited liability company. Pharma-Bio, Pharma-PR, Pharma-Serv, Scienza Labs, Pharma-US, Pharma-IR, Pharma-Spain and Pharma-Brazil are collectively referred to as the “Company.” The Company operates in Puerto Rico, the United States, Ireland, Spain and Brazil under the name of Pharma-Bio Serv and is engaged in providing technical compliance consulting service, and microbiological and chemical laboratory testing.

As more fully detailed on Note J to the condensed consolidated financial statements, on August 13, 2018 the Company entered into an agreement to sell substantially all of its laboratory assets.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated balance sheet of the Company as of October 31, 2017 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 nine months ended July 31, 2018 are not necessarily indicative of expected results for the full 2018 fiscal year.

The accompanying financial data as of July 31, 2018, and for the three-month and nine-month periods ended July 31, 2018 and 2017 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “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 the Company’s audited Consolidated Financial Statements and the notes thereto for the fiscal year ended October 31, 2017.

Consolidation

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

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed



consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from these estimates.

#### Fair Value of Financial Instruments

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

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

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

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



Marketable securities available-for-sale consist of U.S. Treasury securities and an obligation from the Puerto Rico Government Development Bank valued using quoted market prices in active markets. Accordingly, these securities are categorized in Level 1.

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

#### Revenue Recognition

Revenue is primarily derived from: (1) time and materials contracts (representing approximately 87% 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 1% 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 12% of total revenues) is mainly recognized as the testing is completed and certified (normally within days of sample receipt from customer). If the Company determines that a contract will result in a loss, the Company recognizes the estimated loss in the period in which such determination is made.

#### Cash Equivalents

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

#### Marketable Securities

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

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

#### 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 payment term. 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.

The Company follows guidance from the Financial Accounting Standards Board (“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 July 31, 2018, the Company had no significant uncertain tax positions that would be reduced as a result of a lapse of the applicable statute of limitations.



## Property and equipment

Owned property and equipment, and leasehold improvements are stated at cost. 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 the lease term, including renewals that have been determined to be reasonable assured. 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 July 31, 2018 and October 31, 2017, the accumulated depreciation and amortization amounted to \$2,746,826 and \$2,293,329, 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.

## 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 the grant date, while for restricted stock units the fair market value of the units is determined by Company's share market value 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 flows from financing activities since there has been no tax benefit related to the stock-based compensation.

## Earnings (Loss) Per Share of Common Stock

Basic earnings (loss) per share of common stock is calculated by dividing net income (loss) by the weighted average number of shares of common stock outstanding. Diluted loss per share includes the dilution of common stock equivalents, which include principally shares that may be issued upon the exercise of warrants, stock option and restricted stock unit awards.

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 subsidiaries is its local currency. The assets and liabilities of the Company's foreign subsidiaries 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.

#### Subsequent Events

The Company has evaluated subsequent events through the filing date of this report. The Company has determined that there are no events occurring in this period that required disclosure or adjustment, except as disclosed in the accompanying condensed consolidated financial statements.

#### Reclassifications

Certain reclassifications have been made to the July 31, 2017 condensed consolidated financial statements to conform them to the July 31, 2018 condensed consolidated financial statements presentation. Such reclassifications do not affect net loss as previously reported.





## Recent accounting pronouncements

In May 2014, the FASB issued a new accounting standard that amends the guidance for the recognition of revenue from contracts with customers to transfer goods and services. The FASB has subsequently issued additional, clarifying standards to address issues arising from implementation of the new revenue standard. The new standards are required to be adopted using either a full retrospective or a modified retrospective approach. The Company expects to adopt this standard using the modified retrospective approach beginning with the Company's fiscal year 2019. Based on the Company's preliminary assessment, it currently does not anticipate a material impact to the Company's total revenues. The Company continues to review the impact that this new standard will have on its consolidated financial statements.

In February 2016, the FASB issued a new accounting standard that amends the guidance for the accounting and disclosure of leases. This new standard requires that lessees recognize the assets and liabilities that arise from leases on the balance sheet and disclose qualitative and quantitative information about their leasing arrangements. The new standard is effective for interim and annual periods beginning on January 1, 2019 and may be adopted earlier. The Company continues to evaluate the impact that this new standard will have on its consolidated financial statements. The Company does not expect that this standard will have a material impact to its Consolidated Statements of Operations but expects that this standard will have a material impact on the assets and liabilities on its Consolidated Balance Sheets upon adoption.

Other recently issued FASB guidance and SEC Staff Accounting Bulletins have either been implemented, are not applicable to the Company, or will have limited effects upon the Company's implementation.

## NOTE B – MARKETABLE SECURITIES AVAILABLE FOR SALE

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of available-for-sale securities by type of security were as follows as of July 31, 2018 and October 31, 2017:

| Type of security as of July 31, 2018   | Amortized Cost | Gross<br>Unrealized Gains | Gross<br>Unrealized Losses | Estimated<br>Fair Value |
|--|----------------|---------------------------|----------------------------|-------------------------|
| U.S. Treasury securities   | \$4,568,600    | \$-                       | \$-                        | \$4,568,600             |
| Other government-related debt securities:<br>Puerto Rico Commonwealth Government<br>Development Bond | 40,000         | -                         | (1,287)                    | 38,713                  |
| Total interest-bearing and available-for-sale<br>securities  | \$4,608,600    | \$-                       | \$(1,287)                  | \$4,607,313             |
| Type of security as of October 31, 2017  | Amortized Cost | Gross<br>Unrealized Gains | Gross<br>Unrealized Losses | Estimated<br>Fair Value |
| U.S. Treasury securities   | \$4,500,000    | \$-                       | \$-                        | \$4,500,000             |
| Other government-related debt securities:<br>Puerto Rico Commonwealth Government<br>Development Bond | 40,000         | -                         | (13,400)                   | 26,600                  |
|  | \$4,540,000    | \$-                       | \$(13,400)                 | \$4,526,600             |

Total interest-bearing and available-for-sale securities

At July 31, 2018 and October 31, 2017, the above marketable securities included a 5.4% Puerto Rico Commonwealth Government Development Bank Bond maturing in August 2019, purchased at par for \$95,000 and amortized by \$55,000.

8



The fair values of available-for-sale securities by classification in the Consolidated Balance Sheets were as follows as of July 31, 2018 and October 31, 2017:

| Classification in the Consolidated Balance Sheets | July 31,<br>2018 | October 31,<br>2017 |
|---|------------------|---------------------|
| Cash and cash equivalents                         | \$4,568,600      | \$4,500,000         |
| Marketable securities                             | 38,713           | 26,600              |
| Total available-for-sale securities               | \$4,607,313      | \$4,526,600         |

Cash and cash equivalents in the table above exclude cash in banks of approximately \$10.6 million and \$7.2 million as of July 31, 2018 and October 31, 2017, respectively.

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

#### NOTE C - INCOME TAXES

On December 22, 2017, Public Law 115-97, commonly known as the Tax Cuts and Jobs Act of 2017 (the "Tax Reform"), was enacted. The Tax Reform is applicable to the Company commencing with its fiscal year 2018, including the Transition Tax provisions which establishes measurement dates for various computations, November 2, 2017, December 31, 2017 and October 31, 2018. The Tax Reform imposed a mandatory one-time transition tax (the "Transition Tax") over foreign subsidiaries undistributed earnings and profits (E&Ps) earned prior to a date set by the statute. Based on the Company's E&Ps, the Transition Tax is estimated to be approximately \$2.7 million. However, the final Transition Tax due must be assessed with the Company's October 31, 2018 closing figures. The Transition Tax liability may be paid over a period of eight years starting on February 28, 2019. In the past, most of these E&Ps' were not repatriated since such E&Ps' were considered to be reinvested indefinitely in the foreign location, therefore no US tax liability was incurred unless the E&Ps were repatriated as a dividend. After December 31, 2017, the Tax Reform has established a 100% tax exemption on the foreign-source portion of dividends received attributable to E&Ps, with certain limitations.

The SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on accounting for the tax effects of the Tax Reform. SAB 118 provides a measurement period that should not extend beyond one year from the date of the Tax Reform enactment for companies to complete the accounting under Accounting Standards Codification 740—Income Taxes. In accordance with SAB 118, to the extent that a company's accounting for certain income tax effects of the Tax Reform is incomplete, but the company is able to determine a reasonable estimate, it must record a provisional estimate in its financial statements. As described in the preceding paragraph, the Company's accounting for certain elements of the Tax Reform is incomplete. However, the Company was able to make a reasonable estimate of the Transition Tax and recorded a provisional tax obligation of approximately \$2.7 million, as reflected in the condensed consolidated financial statements. The Company is continuing to gather additional information to precisely compute the amount of Transition Tax, and determine whether it will be paid over an eight-year period.

In June 2011, Pharma-Bio, Pharma-PR and Pharma-Serv obtained a Grant of Industrial Tax Exemption pursuant to the terms and conditions set forth in Act No. 73 of May 28, 2008 ("the Grant") issued by the Puerto Rico Industrial Development Company ("PRIDCO"). The Grant was effective as of November 1, 2009 and covers a fifteen year period.

The Grant provides relief on various Puerto Rico taxes, including income tax, with certain limitations, for most of the activities carried on within Puerto Rico, including those that are for services to parties located outside of Puerto Rico. Industrial Development Income (“IDI”) covered under the Grant are subject to a fixed income tax rate of 4%. In addition, IDI earnings distributions accumulated since November 1, 2009 are totally exempt from Puerto Rico earnings distribution tax.

Puerto Rico operations not covered in the exempt activities of the Grant are subject to Puerto Rico income tax at a maximum tax rate of 39% as provided by the 1994 Puerto Rico Internal Revenue Code, as amended. The business activity carried out in the United States by the Company’s subsidiary was taxed in the United States at a maximum regular federal income tax rate of 35%. Among the Tax Reform provisions, effective with the Company’s fiscal year ending on October 31, 2018, is a provision whereby the regular federal income tax rate is reduced to a 23.5% blended rate and 21% thereafter.



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.

Pharma-Spain, Pharma-IR, Pharma-Bio/Pharma-US, Pharma-PR and Pharma-Serv 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 through 2032 for Pharma-Spain; indefinitely for Pharma-IR; until 2037 for Pharma-Bio/Pharma-US; and until 2027 for Pharma-PR and Pharma-Serv.

The statutory income tax rate differs from the effective rate, mainly due to the effect of the non-recurring Transition Tax imposed by the Tax Reform over the Company's E&Ps.

The Company files income tax returns in the United States (federal and various states jurisdictions), Puerto Rico, Ireland, Spain and Brazil. The 2013 (2012 for Puerto Rico) through 2017 tax years are open and may be subject to potential examination in one or more jurisdictions. Currently, the Company has no federal, state, Puerto Rico or foreign income tax examination.

#### NOTE D – WARRANTS

On December 2014, the Company entered into an agreement with a firm for providing (i) business development and (ii) mergers and acquisition services to the Company. Pursuant to the agreement terms, the Company issued warrants for the purchase of 1,000,000 common shares at an exercise price of \$1.80 per share. The underlying common shares of the warrants are fully vested and expire on December 1, 2019.

#### NOTE E – CAPITAL TRANSACTIONS

On June 13, 2014, the Board of Directors of the Company authorized the Company to repurchase up to two million shares of its outstanding common stock. The timing, manner, price and amount of any repurchases will be at the discretion of the Company, subject to the requirements of the Securities Exchange Act of 1934, as amended, and related rules.

The program does not oblige the Company to repurchase any shares and it may be modified, suspended or terminated at any time and for any reason. No shares will be repurchased directly from directors or officers of the Company. As of July 31, 2018 and October 31, 2017, pursuant to the program, a total of 270,552 and 243,452 shares of the Company's common stock were purchased for an aggregate amount of \$261,822 and \$248,163, respectively.

#### NOTE F – EARNINGS (LOSSES) PER SHARE

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

|                                |                               |
|--------------------------------|-------------------------------|
| Three months<br>ended July 31, | Nine months<br>ended July 31, |
|--------------------------------|-------------------------------|

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|  | 2018       | 2017        | 2018          | 2017        |
|--|------------|-------------|---------------|-------------|
| Net income (loss) available to common equity holders - used to compute basic and diluted earnings (losses) per share | \$730,631  | \$(162,982) | \$(2,061,729) | \$(867,880) |
| Weighted average number of common shares - used to compute basic earnings (losses) per share                         | 23,062,531 | 23,101,931  | 23,076,306    | 23,090,207  |
| Effect of warrants to purchase common stock  | -          | -           | -             | -           |
| Effect of restricted stock units to issue common stock   | -          | -           | -             | 3,782       |
| Effect of options to purchase common stock   | 12,075     | -           | 4,452         | 116         |
| Weighted average number of common shares - used to compute diluted earnings (losses) per share                       | 23,074,606 | 23,101,931  | 23,080,758    | 23,094,105  |





For the three-month and nine-month periods ended July 31, 2018 and 2017, warrants for the purchase of 1,000,000 shares of common stock were not considered in computing diluted earnings (losses) per share because the effect was antidilutive. In addition, options for the purchase of 620,000 shares of common stock for the three-month and nine-month periods ended July 31, 2018, and 660,000 shares of common stock for the three-month and nine-month periods ended July 31, 2017, respectively, were not included in computing diluted earnings (loss) per share because their effects were also antidilutive.

#### NOTE G - CONCENTRATIONS OF RISK

##### Cash and Cash Equivalents

The Company's domestic cash and cash equivalents consist of cash deposits in FDIC insured banks (substantially covered by FDIC insurance by the spread of deposits in multiple FDIC insured banks), a money market obligations trust registered under the US Investment Company Act of 1940, as amended, and U.S. Treasury securities with maturities of three months or less. In the foreign markets the Company serves, the Company also maintains cash deposits in foreign banks, which tend not to be significant and have no specific insurance. 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, Ireland and Spain. 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 two customers, which accounted for 10% or more of its revenues in either of the three-month and nine-month periods ended July 31, 2018 and 2017. During the three months ended July 31, 2018, revenues from these customers were 9.8% and 22.6%, or a total of 32.4%, as compared to the same period last year of 14.9% and 2.9%, or a total of 17.8%, respectively. During the nine months ended July 31, 2018, revenues from these customers were 14.0% and 13.1%, or a total of 27.1%, as compared to the same period last year of 13.4% and 1.2%, or a total of 14.6%, respectively. At July 31, 2018, amounts due from these customers represented 35.3% of the Company's total accounts receivable balance. This major customers information is based on revenues earned from said customers at the segment level because in management's opinion contracts by segments are totally independent of each other, and therefore such information is more meaningful to the reader.

At the global level, three global groups of affiliated companies accounted for 10% or more of its revenues in either of the three-month and nine-month periods ended July 31, 2018 and 2017. During the three months ended July 31, 2018, aggregate revenues from these global groups of affiliated companies were 9.8%, 22.6% and 11.1%, or a total of 43.5%, as compared to the same period last year for 14.9%, 2.9%, and 11.9%, or a total of 29.7%, respectively. During the nine months ended July 31, 2018, aggregate revenues from these global group of affiliated companies were 14.0%, 13.1% and 5.7%, or a total of 32.8%, as compared to the same period last year for 13.4%, 1.2% and 11.4%, or a total of 26.0%, respectively. At July 31, 2018, amounts due from these global groups of affiliated companies represented 39.9% of total accounts receivable balance.

#### NOTE H – OTHER INCOME

During September 2017, the Company's Puerto Rico operations were affected by hurricanes which severely impacted Puerto Rico ("Hurricanes"). The Company's insurance claim for property damages resulting from the Hurricanes was

settled with the insurance carrier on July 2018 for the aggregate amount of approximately \$148,000. Business interruption losses and additional expenses incurred by the Company until electrical power and other basic utilities were restored is currently being assessed by the Company's insurance provider. Based on current accounting guidance, the insurance proceeds are being recognized upon collection, as a gain contingency against other income in the accompanying condensed financial statements.

Administered and disbursed by the Puerto Rico Treasury Department, the United States federal government granted a salaries subsidy (the "Salaries Subsidy") to Puerto Rico employers which retained employees for the period since the Hurricanes until the sooner of (i) when the employer operations were fully able to operate, or (ii) December 31, 2017. During July 2018, the Company's Puerto Rico subsidiaries applied and collected from the Salaries Subsidy an aggregate amount of approximately \$220,000. This Salaries Subsidy was recorded against other income in the accompanying condensed financial statements.



## NOTE I - SEGMENT DISCLOSURES

The Company's segments are based on the organizational structure for which financial results are regularly evaluated by the Company's senior executive management to determine resource allocation and assess performance. Each reportable segment is managed by its own management team and reports to executive management. The Company has four reportable segments: (i) Puerto Rico technical compliance consulting, (ii) United States technical compliance consulting, (iii) Europe technical compliance consulting, and (iv) a Puerto Rico microbiological and chemical laboratory testing division ("Lab"). These reportable segments provide services primarily to the pharmaceutical, chemical, medical device and biotechnology industries in their respective markets.

The following table presents information about the reported revenues from services and earnings from operations of the Company for the three-month and nine-month periods ended in July 31, 2018 and 2017. There is no intersegment revenue for the mentioned periods. Corporate expenses that support the operating units have been allocated to the segments. Asset information by reportable segment is not presented, since the Company does not produce such information internally, nor does it use such data to manage its business.

|  | Three months ended July 31, |             | Nine months ended July 31, |              |
|--|-----------------------------|-------------|----------------------------|--------------|
|  | 2018                        | 2017        | 2018                       | 2017         |
| <b>REVENUES:</b>                           |                             |             |                            |              |
| Puerto Rico consulting                     | \$3,825,156                 | \$2,811,850 | \$9,737,886                | \$8,362,141  |
| United States consulting                   | 684,051                     | 366,353     | 1,311,882                  | 1,015,175    |
| Europe consulting                          | 111,156                     | 214,761     | 1,042,086                  | 576,032      |
| Lab (microbiological and chemical testing) | 549,380                     | 527,886     | 1,611,954                  | 1,730,072    |
| Other segments <sup>1</sup>                | 45,685                      | 59,290      | 128,409                    | 264,178      |
| Total consolidated revenues                | \$5,215,428                 | \$3,980,140 | \$13,832,217               | \$11,947,598 |
| <b>INCOME (LOSS) BEFORE TAXES:</b>         |                             |             |                            |              |
| Puerto Rico consulting                     | \$596,529                   | \$(168,749) | \$708,625                  | \$(294,998)  |
| United States consulting                   | 42,737                      | 81,202      | (132,964)                  | (294,010)    |
| Europe consulting                          | (114,873)                   | (59,758)    | 12,151                     | (151,726)    |
| Lab (microbiological and chemical testing) | (17,014)                    | (76,163)    | (236,511)                  | (296,763)    |
| Other segments <sup>1</sup>                | 258,804                     | 61,836      | 323,545                    | 172,823      |
| Total consolidated income before taxes     | \$766,183                   | \$(161,632) | \$674,846                  | \$(864,674)  |

Other segments represent activities that fall below the reportable threshold and are carried out in Puerto Rico, United States and Brazil. These activities include a Brazilian compliance consulting division, technical seminars/training division, a calibrations division and corporate headquarters, as applicable.

Long lived assets (property and equipment and intangible assets) as of July 31, 2018 and October 31, 2017, and related depreciation and amortization expense for the three and nine months ended July 31, 2018 and 2017, were concentrated in the Lab in Puerto Rico. Accordingly, depreciation expense and acquisition of property and equipment, as presented in the statement of cash flows are mainly related to the Lab.

NOTE J – SUBSEQUENT EVENT

On August 13, 2018, a subsidiary of the Company entered into an Asset Purchase Agreement (the “Purchase Agreement”) to sell substantially all of its laboratory business assets (the “Laboratory Assets”) to a third party (the “Buyer”) as part of its manufacturing operations. Pursuant to the Purchase Agreement, the aggregate consideration to be paid by the Buyer for the Laboratory Assets, in addition to the assumption of certain assumed liabilities as set forth in the Purchase Agreement, is \$5,000,000 payable at closing as follows: (i) \$1,750,000 in cash, (ii) \$3,000,000 in the form of a promissory note payable over two years, and (iii) the application of \$250,000 previously paid by the Buyer as a deposit. In connection with the Purchase Agreement, the Buyer deposited the cash consideration into an escrow account pursuant to an Escrow Agreement, dated August 13, 2018. The Company anticipates that the closing of the transaction will occur within sixty days of signing the Purchase Agreement, subject to customary closing conditions.



## 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, 2017. 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, 2017.

### 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, Europe and Brazil 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 chemical testing services through our laboratory testing facility ("Lab") in Puerto Rico. We also provide technical training/seminars, which services are not currently significant to our operating results. We market our services to pharmaceutical, chemical, biotechnology, medical devices, cosmetics and food industries, and allied products companies in Puerto Rico, the United States, Europe and Brazil. Our consulting team includes experienced engineering and life science professionals, former quality assurance managers and directors, and professionals with bachelors, masters and doctorate degrees in health sciences and engineering.

We consider our core business to be FDA and international agencies regulatory compliance consulting related services. Within our portfolio of services, we also provide microbiological and chemical laboratory testing services to our core industries already serviced in Puerto Rico. However, we recently decided to concentrate and refocus our efforts on consulting services. As a result, on August 13, 2018, we entered into an agreement with a third party to sell substantially all of our laboratory business assets for \$5 million. The Company anticipates that the closing of the transaction will occur within sixty days from the agreement date. For further details see Note J to the condensed consolidated financial statements included herewith.

We actively operate in Puerto Rico, the United States, Ireland, Spain and Brazil and pursue to further expand these markets by strengthening our business development infrastructure and by constantly realigning our business strategies as new opportunities and challenges arise.

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 consultants or dollar volume) and responding to prospective customers' requests for proposals.

In line with the strategy to further penetrate the United States and Puerto Rico markets, we submit annually for renewal the certification as a "minority-controlled company" as defined by the National Minority Supplier Development Council and Growth Initiative ("NMSDC"). This certification, which has been held by us since July 2008, allows us to participate in corporate diversity programs available from various potential customers in the United States and Puerto Rico.



The Company holds a tax grant issued by the Puerto Rico Industrial Development Company (“PRIDCO”), which provides relief on various Puerto Rico taxes, including income tax, with certain limitations, for most of the activities carried on within Puerto Rico, including those that are for services to parties located outside of Puerto Rico.



As more fully disclosed in our Annual Report on Form 10-K for the year ended October 31, 2017, during September 2017, our Puerto Rico operations were affected by hurricanes which severely impacted Puerto Rico (the “Hurricanes”). Within a few days of the last hurricane affecting Puerto Rico in September 2017, we resumed operations using a diesel power generator at our Puerto Rico facilities. Our electrical power and other basic utilities were restored on November 22, 2017. By April 30, 2018, our clients’ businesses in Puerto Rico were restored. The Company’s insurance claim for property damages resulting from the Hurricanes was settled with the insurance carrier in July 2018 for the aggregate amount of approximately \$148,000. Business interruption losses and additional expenses incurred by us until electrical power and other basic utilities were restored is currently being assessed by our insurance provider. As a result of the Hurricanes, the United States federal government granted a salaries subsidy to Puerto Rico employers which retained employees for a specific period of time. During July 2018, the Company’s Puerto Rico subsidiaries applied and collected an aggregate amount of approximately \$220,000 related to this salary subsidy. (See Note H to our condensed consolidated financial statements for further details.)

As more fully disclosed in Note C of the Company’s condensed consolidated financial statements included herewith, we are subject to the recent Tax Reform provisions, including an estimated one-time non-recurring Transition Tax of \$2.7 million, payable within eight years starting on February 2019. The payment will be funded from our working capital.

The following table sets forth information as to our revenue for the three-month and nine-month periods ended July 31, 2018 and 2017, by geographic regions (dollars in thousands).

| Revenues by Region: | Three months ended July 31, |        |         |        | Nine months ended July 31, |        |          |        |
|---------------------|-----------------------------|--------|---------|--------|----------------------------|--------|----------|--------|
|                     | 2018                        |        | 2017    |        | 2018                       |        | 2017     |        |
| Puerto Rico         | \$4,409                     | 84.6%  | \$3,377 | 84.9%  | \$11,447                   | 82.8%  | \$10,332 | 86.5%  |
| United States       | 684                         | 13.1%  | 366     | 9.2%   | 1,312                      | 9.5%   | 1,015    | 8.5%   |
| Europe              | 111                         | 2.1%   | 215     | 5.4%   | 1,042                      | 7.5%   | 576      | 4.8%   |
| Other               | 11                          | 0.2%   | 22      | 0.5%   | 31                         | 0.2%   | 24       | 0.2%   |
|                     | \$5,215                     | 100.0% | \$3,980 | 100.0% | \$13,832                   | 100.0% | \$11,947 | 100.0% |

For the nine-month period ended July 31, 2018, revenues for the Company were \$13.8 million, an increase of \$1.9 million when compared to the same period last year. The revenue increase is mainly attributable to increases in projects in the Puerto Rico, US and European consulting markets of \$1.4, \$0.3 and \$0.4 million, respectively, partially offset by a decline in each of the Puerto Rico Lab and Calibration operations of \$0.1 million, respectively. Other Company divisions sustained minor revenue gains/losses or remained constant. When compared to the same period last year, gross margin increased 1.6 percentage points. The net increase in gross margin is mainly attributable to recent favorable Puerto Rico consulting project margins when compared to the same period last year. Selling, general and administrative expenses were approximately \$3.5 million, a net decrease of \$444,000 when compared to the same period last year. The decrease is mainly attributable to cost reduction measures geared to align our operational support expenses to the market conditions. These reductions include, among others, the closing of operational satellite offices and the net reduction of business development and global support personnel. During July 2018, we received non-recurring proceeds from the insurance claim for property damages resulting from the Hurricanes and Salaries Subsidy of approximately \$148,000 and \$220,000, respectively. These factors contributed to our income before income tax and US Tax Reform Transition Tax expense of approximately \$675,000, an earnings improvement of approximately \$1,540,000, when compared to the same period last year. (See “Results of Operations” below.)

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The long-term impacts of the Hurricanes, the Puerto Rico government financial crisis, the Tax Reform, other tax reforms on the markets where we do business, and Puerto Rico Act 154-2010, all pose current and future challenges which may adversely affect our future performance. We believe that our future profitability and liquidity will be highly dependent on the effect the local economy and global economy, changes in tax laws and healthcare reform, and worldwide lifescience manufacturing industry consolidations will have on our operations, and our ability to seek service opportunities and adapt to industry trends.



## Results of Operations

The following table sets forth our statements of operations for the three-month and nine-month periods ended July 31, 2018 and 2017, (dollars in thousands) and as a percentage of revenue:

|  | Three months ended July 31, |        |         |        | Nine months ended July 31, |        |          |        |
|--|-----------------------------|--------|---------|--------|----------------------------|--------|----------|--------|
|  | 2018                        |        | 2017    |        | 2018                       |        | 2017     |        |
| Revenues   | \$5,215                     | 100.0% | \$3,980 | 100.0% | \$13,832                   | 100.0% | \$11,947 | 100.0% |
| Cost of services   | 3,607                       | 69.2%  | 3,052   | 76.7%  | 10,134                     | 73.3%  | 8,946    | 74.9%  |
| Gross profit   | 1,608                       | 30.8%  | 928     | 23.3%  | 3,698                      | 26.7%  | 3,001    | 25.1%  |
| Selling, general and administrative costs                            | 1,240                       | 23.7%  | 1,122   | 28.2%  | 3,460                      | 25.0%  | 3,904    | 32.7%  |
| Other income, net  | 398                         | 7.6%   | 32      | 0.8%   | 437                        | 3.2%   | 38       | 0.3%   |
| Net income (loss) before income tax and US Tax Reform Transition Tax | 766                         | 14.7%  | (162)   | -4.1%  | 675                        | 4.9%   | (865)    | -7.3%  |
| Income tax and US Tax Reform Transition Tax expense                  | 35                          | 0.7%   | 1       | -%     | 2,737                      | 19.8%  | 3        | -%     |
| Net income (loss)  | 731                         | 14.0%  | (163)   | -4.1%  | (2,062)                    | -14.9% | (868)    | -7.3%  |

Revenues. Revenues for the three and nine months ended July 31, 2018 were \$5.2 and \$13.8 million, respectively, an increase of approximately \$1.2 and \$1.9 million, or 31.0% and 15.8%, respectively, when compared to the same periods last year.

The increase for the three months ended July 31, 2018, when compared to the same period last year, is mainly attributable to increases in projects in the Puerto Rico and US consulting markets of approximately \$1.0 and \$0.3 million, respectively, partially offset by a decrease on the European division of \$0.1 million. Other Company divisions sustained minor revenue gains/losses or remained constant, when compared to the same period last year.

The increase for the nine months ended in July 31, 2018, when compared to the same period last year, is mainly attributable to increases in projects in the Puerto Rico, US and European consulting markets of \$1.4, \$0.3 and \$0.4 million, respectively, partially offset by a decline in each of the Puerto Rico Lab and Calibration operations of \$0.1 million, respectively. Other Company divisions sustained minor revenue gains/losses or remained constant.

Cost of Services; gross margin. The increase of 7.5 and 1.6 percentage points in gross margin for the three months and nine months ended July 31, 2018, respectively, is mainly attributable to recent favorable Puerto Rico consulting project margins when compared to the same period last year.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three and nine months ended July 31, 2018 were approximately \$1.2 and \$3.5 million, an increase of approximately \$0.1 million and a decrease of \$0.4 million, when compared to the same periods last year, respectively. The increase for the three months ended July 31, 2018 is mainly related to various non-recurring general expenses incurred during the period, including those related to the anticipated sale of substantially all of our laboratory business assets. The decrease for the nine-month period ended July 31, 2018 is mainly attributable to cost reduction measures adopted since the end of fiscal year 2017 geared to align our operational support expenses to the market conditions. These reductions include, among others, the closing of operational satellite offices and the net reduction of business development and global support personnel.

Other Income and Expense, net. Other income for both the three and nine-months periods ended on July 31, 2018 increased by approximately \$0.4 million, when compared to the same periods last year. The increase is mainly attributable to proceeds from the Salaries Subsidy and insurance claim for property damages resulting from the Hurricanes of approximately \$220,000 and \$148,000, respectively, collected during July 2018. For additional information see Note H to the Company's condensed consolidated financial statements included herewith.

Income Tax and US Tax Reform Transition Tax Expense. The income tax expense is mainly attributable to the effect of the \$2.7 million non-recurring Transition Tax imposed by the Tax Reform over the Company's E&Ps. For additional information on the Transition Tax, see Note C of the Company's condensed consolidated financial statements included herewith.





Net Income (Loss). For the three and nine months ended July 31, 2018, our income before income tax and US Tax Reform Transition Tax was approximately \$766,000 and \$675,000, respectively, an improvement of \$928,000 and \$1,540,000 when compared to the same periods last year, respectively. The variance is mainly attributable to the improvement in revenue, savings in operational support expenses, and the proceeds from the Salaries Subsidy and insurance claim for property damages resulting from the Hurricanes.

After considering the Tax Reform \$2.7 million Transition Tax adjustment recorded during our first quarter of the current fiscal year, for the three and nine months periods ended July 31, 2018 we attained net income of \$0.7 million and a net loss of \$2.1 million, respectively. This represents an improvement in net earnings of \$0.9 million for the three months ended July 31, 2018 and a decrease in earnings of \$1.2 million for the nine months ended July 31, 2018, when compared to the same periods last year.

For the three and nine months ended July 31, 2018, net income (loss) before income tax and Transition Tax per common share for both basic and diluted was \$0.033 and \$0.029, respectively, an improvement of \$0.040 and \$0.066 per share, when compared to the same periods last year, respectively.

After considering the income tax and the US Tax Reform Transition Tax adjustment recorded during the first quarter of the current fiscal year, net income (loss) per common share for both basic and diluted for the three and nine months ended July 31, 2018 was an earnings of \$0.032 and a loss of \$0.089, respectively, an improvement of \$0.039 per share and a decline of \$0.051 per share when compared to the same periods last year, respectively.

#### Liquidity and Capital Resources

Liquidity is a measure of our ability to meet potential cash requirements, including planned capital expenditures. As of July 31, 2018, the Company had approximately \$18.8 million in working capital.

On June 13, 2014, the Board of Directors of the Company authorized the Company to repurchase up to two million shares of its common stock (the "Company Stock Repurchase Program"). During the nine-month period ended July 31, 2018, the Company repurchased 27,100 shares of its common stock.

Our primary cash needs consist of the payment of compensation to our consulting team, overhead expenses, and statutory taxes. Additionally, we may use cash for the repurchase of our common stock under the Company Stock Repurchase Program, capital expenditures and business development expenses (as described above on "Results of Operations"). Management believes that based on the current level of working capital, operations and cash flows from operations, and 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, as described above, management is not aware of any other matters likely to have a material adverse effect on the Company's liquidity or its financial statements.

#### Off-Balance Sheet Arrangements

We were not involved in any significant off-balance sheet arrangement during the nine months ended July 31, 2018.

### Critical Accounting Policies and Estimates

There were no material changes during the nine months ended July 31, 2018 to the critical accounting policies reported in our Annual Report on Form 10-K for the fiscal year ended October 31, 2017.

### 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, 2017, 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, except as required by law. 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:

Because our business is concentrated in the lifescience and medical devices industries in Puerto Rico, the United States, Europe and Brazil, any changes in those industries or in those markets could impair our ability to generate revenue and realize a profit.

Puerto Rico’s economy, including its governmental financial crisis and the impact of the Hurricanes, may affect the willingness of businesses to commence or expand operations in Puerto Rico, or may also consider closing operations located in Puerto Rico.

Puerto Rico government enacted ACT 154-2010 may adversely affect the willingness of our customers to do business in Puerto Rico and consequently adversely affect our business.

US Federal Tax Reform may affect the willingness of companies to continue or expand their operations in Puerto Rico.

Further changes in tax laws in Puerto Rico or in other jurisdictions may adversely impact the willingness of our customers to continue or expand their Puerto Rico operations.

Our business and operating results may be adversely impacted if we are unable to maintain our certification as a minority-controlled company.

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 effect 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.

Changes in public policy impacting the industries we serve could adversely affect 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.

Our reputation and divisions may be impacted by regulatory standards applicable to our customer products.

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 and technical personnel, our ability to develop our business may be impaired if we are not able to engage skilled personnel.

Our cash could be adversely affected if the financial institutions in which we hold our cash fail.

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 revenues, operating results and profitability will vary from quarter to quarter, which may result in increased volatility of our stock price.

The Company Stock Repurchase Program could affect the market price of our common stock and increase its volatility.

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.





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:

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.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

\* Furnished herewith



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/ Victor Sanchez

Victor Sanchez

Chief Executive Officer and President Europe Operations

(Principal Executive Officer)

/s/ Pedro J. Lasanta

Pedro J. Lasanta

Chief Financial Officer and Vice President Finance and Administration

(Principal Financial Officer and Principal Accounting

Officer)

Dated: September 14, 2018