

Pharma-Bio Serv, Inc.
Form 10-Q
March 17, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2014

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

For the transition period from _____ to _____

Commission File No. 000-50956

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

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

20-0653570
(IRS Employer
Identification No.)

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

00646
(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Edgar Filing: Pharma-Bio Serv, Inc. - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares of the registrant's common stock outstanding as of March 14, 2014 was 23,049,462.

PHARMA-BIO SERV, INC.
FORM 10-Q
FOR THE QUARTER ENDED JANUARY 31, 2014

TABLE OF CONTENTS

	Page
PART I FINANCIAL INFORMATION	
Item 1 – Financial Statements	
Condensed Consolidated Balance Sheets as of January 31, 2014 and October 31, 2013 (unaudited)	3
Condensed Consolidated Statements of Income for the three-month periods ended January 31, 2014 and 2013 (unaudited)	4
Condensed Consolidated Statements of Comprehensive Income for the three-month periods ended January 31, 2014 and 2013 (unaudited)	5
Condensed Consolidated Statements of Cash Flows for the three-month periods ended January 31, 2014 and 2013 (unaudited)	6
Notes to Condensed Consolidated Financial Statements (unaudited)	7
Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 4 – Controls and Procedures	19
PART II OTHER INFORMATION	
Item 1 – Legal Proceedings	20
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	20
Item 6 – Exhibits	20
SIGNATURES	21

PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

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

	January 31, 2014*	October 31, 2013**
ASSETS:		
Current assets		
Cash and cash equivalents	\$ 13,782,775	\$ 12,045,923
Marketable securities	64,124	71,260
Accounts receivable	5,671,395	7,403,987
Other	658,729	767,452
Total current assets	20,177,023	20,288,622
Property and equipment	884,477	976,423
Other assets	16,839	16,891
Total assets	\$ 21,078,339	\$ 21,281,936
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities		
Current portion-obligations under capital leases	\$ 27,680	\$ 32,188
Accounts payable and accrued expenses	1,844,385	2,825,532
Income taxes payable	419,238	322,731
Total current liabilities	2,291,303	3,180,451
Obligations under capital leases	45,873	51,724
Total liabilities	2,337,176	3,232,175
Stockholders' equity:		
Preferred Stock, \$0.0001 par value; authorized 10,000,000 shares; none outstanding	-	-
Common Stock, \$0.0001 par value; authorized 50,000,000 shares; issued and outstanding 23,043,094 and 22,702,186 shares at January 31, 2014 and October 31, 2013, respectively	2,304	2,271
Additional paid-in capital	978,136	931,039
Retained earnings	17,855,106	17,193,203
Accumulated other comprehensive loss	(94,383)	(76,752)
Total stockholders' equity	18,741,163	18,049,761
Total liabilities and stockholders' equity	\$ 21,078,339	\$ 21,281,936

* Unaudited.

** Condensed from audited financial statements.

See notes to condensed consolidated financial statements.

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

	Three months ended January 31,	
	2014	2013
REVENUES	\$7,007,652	\$7,654,392
COST OF SERVICES	4,635,451	5,087,624
GROSS PROFIT	2,372,201	2,566,768
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,544,581	1,276,464
INCOME FROM OPERATIONS	827,620	1,290,304
OTHER INCOME, NET	-	229
INCOME BEFORE INCOME TAXES	827,620	1,290,533
INCOME TAX EXPENSE	165,687	237,288
NET INCOME	\$661,933	\$1,053,245
BASIC EARNINGS PER COMMON SHARE	\$0.029	\$0.051
DILUTED EARNINGS PER COMMON SHARE	\$0.028	\$0.046
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	22,776,093	20,785,934
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED	23,725,279	22,818,031

See notes to condensed consolidated financial statements.

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

	Three months ended January 31,	
	2014	2013
NET INCOME	\$661,933	\$1,053,245
OTHER COMPREHENSIVE (LOSS) INCOME, NET OF RECLASSIFICATION ADJUSTMENTS AND TAXES:		
Foreign currency translation (loss) gain	(10,495)	28,360
Net unrealized losses on available-for-sale securities	(7,136)	-
TOTAL OTHER COMPREHENSIVE (LOSS) INCOME	(17,631)	28,360
COMPREHENSIVE INCOME	\$644,302	\$1,081,605

See notes to condensed consolidated financial statements.

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

	Three months ended January 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$661,933	\$1,053,245
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	17,100	2,166
Depreciation and amortization	91,655	81,078
Decrease (increase) in accounts receivable	1,731,636	(66,693)
Decrease (increase) in other assets	108,691	(57,849)
Decrease in liabilities	(859,363)	(568,961)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,751,652	442,986
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	-	(81,455)
NET CASH USED IN INVESTING ACTIVITIES	-	(81,455)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	-	109,859
Payments on obligations under capital lease	(10,359)	(9,563)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(10,359)	100,296
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(4,441)	12,011
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,736,852	473,838
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	12,045,923	6,538,113
CASH AND CASH EQUIVALENTS – END OF PERIOD	\$13,782,775	\$7,011,951
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Income taxes	\$69,180	\$146,224
Interest	\$1,305	\$2,100
SUPPLEMENTARY SCHEDULES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Income tax withheld by clients to be used as a credit in the Company's income tax return	\$9,070	\$-
Conversion of cashless exercise of warrants and options to shares of common stock	\$30	\$-
Issuance of common stock pursuant to agreement with investor relations firm	\$30,000	\$60,000

See notes to condensed consolidated financial statements.

PHARMA-BIO SERV, INC.
Notes To Condensed Consolidated Financial Statements
January 31, 2014
(Unaudited)

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated balance sheet of the Company as of October 31, 2013 is derived from audited consolidated financial statements but does not include all disclosures required by generally accepted accounting principles. The unaudited interim condensed consolidated financial statements, include all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations and cash flows for the interim periods. The results of operations for the three months ended January 31, 2014 are not necessarily indicative of expected results for the full 2014 fiscal year.

The accompanying financial data as of January 31, 2014, and for the three-month period ended January 31, 2014 and 2013 has been prepared by us, 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 our audited Consolidated Financial Statements and the notes thereto for the fiscal year ended October 31, 2013.

Consolidation

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

Use of Estimates

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

Actual results may differ from these estimates.

Fair Value of Financial Instruments

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

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

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

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

Marketable securities 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 93% 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 6% 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.

Accounts Receivable

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

Income Taxes

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

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 January 31, 2014, 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 initial lease term. Major renewals and betterments that extend the life of the assets are capitalized, while expenditures for repairs and maintenance are expensed when incurred. As of January 31, 2014 and October 31, 2013, the accumulated depreciation and amortization amounted to \$1,972,001 and \$1,880,346, 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. Excess tax benefits related to stock-based compensation are reflected as cash flows from financing activities rather than cash flows from operating activities. The Company has not recognized such cash flow from financing activities since there has been no tax benefit related to the stock-based compensation.

Income Per Share of Common Stock

Basic income per share of common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding. Diluted income per share includes the dilution of common stock equivalents, 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. The net gains and losses recorded in the condensed consolidated statements of income were not significant for the periods presented.

Reclassifications

Certain reclassifications have been made to the January 31, 2013 condensed consolidated financial statements to conform them to the January 31, 2014 condensed consolidated financial statements presentation. Such reclassifications do not affect net income as previously reported.

Recently issued and adopted accounting standards

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

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 January 31, 2014 and October 31, 2013:

Type of security as of January 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 4,500,000	\$ —	\$ —	\$ 4,500,000
Other government-related debt securities:				
Puerto Rico Commonwealth Government Development Bond	95,000	—	(30,876)	64,124
Total interest-bearing and available-for-sale securities	\$ 4,595,000	\$ —	\$ (30,876)	\$ 4,564,124

Type of security as of October 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ \$4,500,000	\$ —	\$ —	\$ 4,500,000
Other government-related debt securities:				
Puerto Rico Commonwealth Government Development Bond	95,000	—	(23,740)	71,260
Total interest-bearing and available-for-sale securities	\$ \$4,595,000	\$ —	\$ (23,740)	\$ 4,571,260

At January 31, 2014 and October 31, 2013, the above marketable securities included a \$95,000 5.4% Puerto Rico Commonwealth Government Development Bank Bond, purchased at par and maturing in August 2019.

The fair values of available-for-sale securities by classification in the Consolidated Balance Sheets were as follows as of January 31, 2014 and October 31, 2013:

Classification in the Consolidated Balance Sheets	January 31, 2014	October 31, 2013
Cash and cash equivalents	\$4,500,000	\$4,500,000
Marketable securities	64,124	71,260
Total available-for-sale securities	\$4,564,124	\$4,571,260

Cash and cash equivalents in the table above exclude cash in banks of approximately \$9.3 and \$7.5 million as of January 31, 2014 and October 31, 2013, 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.

We review our available-for-sale securities for other-than-temporary declines in fair value below their recorded basis on a quarterly basis and whenever events or changes in circumstances indicate that the recorded basis of an asset may not be recoverable. This evaluation is based on a number of factors including, the length of time and extent to which the fair value has been less than our recorded basis and adverse conditions specifically related to the security including any changes to the rating of the security by a rating agency. As of January 31, 2014 and October 31, 2013, we believe that the recorded base for our available-for-sale securities were recoverable in all material respects.

NOTE C - INCOME TAXES

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. The Grant establishes a threshold (“Baseline”) on the Industrial Development Income (“IDI”) subject to the favorable income tax rates. Within a four year term ending with the taxable year ending October 31, 2013, the Baselines were gradually reduced to zero. Certain activities covered under the Grant were not subject to a Baseline and were allowed a four year gradual phase-in from the maximum income tax rate of 30%, as provided by the 1994 Puerto Rico Internal Revenue Code, to the favorable fixed Act 73 income tax rate of 4%, which is effective to the taxable year ended in October 31, 2013. In addition, IDI earnings distributions accumulated since November 1, 2009 are totally exempt from Puerto Rico earnings distribution tax.

Effective with our fiscal year ended October 31, 2014, 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 operations carried out in the United States by the Company’s subsidiary are taxed in the United States at a maximum regular federal income tax rate of 35%.

Distribution of earnings by the Puerto Rican subsidiaries to its parent 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. 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, federal taxes on operations in the United States, plus the earnings distribution tax in Puerto Rico from dividends paid to the Puerto Rican subsidiaries’ parent, and the parent’s federal income tax, if any, incurred upon the subsidiary’s earnings distribution.

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

The Company has not recognized deferred income taxes on undistributed earnings of its Puerto Rican subsidiaries, 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 Puerto Rico earnings distribution tax and United States federal income tax, as applicable.

Pharma-Spain and Pharma-IR have unused operating losses which result in a potential deferred tax asset. However, an allowance has been provided covering the total amount of such balance since it is uncertain whether the net operating losses can be used to offset future taxable income before their expiration dates. Realization of future tax benefits related to a deferred tax asset is dependent on many factors, including the company’s ability to generate taxable income. Accordingly, the income tax benefit will be recognized when realization is determined to be more probable than not. These net operating losses are available to offset future taxable income until October 31, 2018 for Pharma-Spain and indefinitely for Pharma-IR.

The statutory income tax rate differs from the effective rate, mainly due to the effect of the Puerto Rico Act 73 Tax Grant over income tax expense, and income tax permanent differences between financial and tax books income.

The Company files income tax returns in the United States (federal and various states jurisdictions), Puerto Rico and Ireland. The 2010 (2009 for Puerto Rico) through 2013 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

At October 31, 2013, the Company had outstanding warrants to purchase 240,800 shares of the Company's common stock at an exercise price of \$0.06. In January 2014, all of these warrants were exercised on a cashless basis, resulting in a net issuance of 233,763 shares of common stock. As of January 31, 2014, the Company had no warrants outstanding.

NOTE E – CAPITAL TRANSACTIONS

On January 23, 2013, the Company entered into an agreement with an investor relations firm to assist in the Company's shareholder communication efforts. For these services, in addition to a monthly fee of \$10,000, the Company agreed to issue to the investor relations firm a total of 150,000 shares during the one year term of the agreement (75,000, 37,500 and 37,500 shares in January 2013, July 2013 and January 2014, respectively). As of January 31, 2014, pursuant to the terms of the agreement with the investor relations firm, all shares were issued. Effective February 1, 2014, the agreement with the investor relations firm was renegotiated for a term of one year. Under the new provisions of the agreement, the Company will no longer grant common shares to the investor relations firm, all other provisions of the original agreement were maintained.

During the three months ended January 31, 2014, in addition to the 37,500 common shares issued pursuant to the agreement with the investor relations firm, warrants and options were exercised on a cashless basis resulting in a net issuance of the Company's common shares in the aggregate amount of 233,763 and 69,645, respectively.

NOTE F – EARNINGS PER SHARE

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

	Three months ended January 31,	
	2014	2013
Net income available to common equity holders - used to compute basic and diluted earnings per share	\$661,933	\$1,053,245
Weighted average number of common shares - used to compute basic earnings per share	22,776,093	20,785,934
Effect of warrants to purchase common stock	190,387	1,892,881
Effect of restricted stock units to common stock	17,345	-
Effect of options to purchase common stock	741,454	139,216
Weighted average number of shares - used to compute diluted earnings per share	23,725,279	22,818,031

Options for the purchase of 80,000 shares of common stock for the three-month period ended in January 31, 2014 were not included in computing diluted earnings per share because their effect were antidilutive.

NOTE G - CONCENTRATIONS OF RISK

Cash and cash equivalents

The Company 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 we serve, we also maintain cash deposits in foreign banks, which tend to be not 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 three customers, which accounted for 10% or more of its revenues in either of the three-month periods ended January 31, 2014 and 2013. During the three months ended January 31, 2014, revenues from these customers were 24.7%, 15.0%, and 6.1%, or a total of 45.8%, as compared to the percentages for the same period last year of 28.3%, 13.5%, and 13.1%, or a total of 54.9%, respectively. At January 31, 2014, amounts due from these customers represented 32.4% of the Company's total accounts receivable balance.

The information related to major customers in the above paragraph 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. These revenues pertain to two global groups of affiliated companies. During the three months ended January 31, 2014, aggregate revenues from these global groups of affiliated companies were 45.3% and 6.1%, or a total of 51.4%, as compared to the same period last year for 51.4% and 13.1%, or a total of 64.5%, respectively. At January 31, 2014 amounts due from these global groups of affiliated companies represented 42.7% of total accounts receivable balance.

NOTE H - 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 revenue from services and earnings from operations of the Company for the three month period ended in January 31, 2014 and 2013. 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 January 31,	
	2014	2013
REVENUES:		
Puerto Rico consulting	\$3,521,211	\$3,544,765
United States consulting	2,321,340	2,749,703
Europe consulting	683,329	854,774
Lab (microbiological and chemical testing)	453,056	366,646
Other segments ¹	28,716	138,504
Total consolidated revenues	\$7,007,652	\$7,654,392
INCOME (LOSS) BEFORE TAXES:		
Puerto Rico consulting	\$618,347	\$778,303

United States consulting	334,923	572,311
Europe consulting	(81,444)	(84,733)
Lab (microbiological and chemical testing)	19,073	(10,291)
Other segments ¹	(63,279)	34,943
Total consolidated income before taxes	\$827,620	\$1,290,533

¹ Other segments represent activities that fall below the reportable threshold and are carried out in Puerto Rico and the United States. These activities include a technical seminars/training division, an information technology services and consulting division, and corporate headquarters, as applicable.

Long lived assets (property and equipment and intangible assets) as of January 31, 2014 and October 31, 2013, and related depreciation and amortization expense for the three months ended January 31, 2014 and 2013, were concentrated in the domestic markets (Puerto Rico and the United States). The aggregate amount of long lived assets for the international operations (Europe) is considered insignificant.

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, 2013. 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, 2013.

Overview

We are a compliance, project management and technology transfer support consulting firm with a laboratory testing facility with headquarters in Puerto Rico, servicing the Puerto Rico, United States and Europe markets. The compliance consulting service sector in those markets consists of local compliance and validation consulting firms, 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 information technology consulting services and technical training/seminars, which services are not currently significant to our operating results. We market our services to pharmaceutical, chemical, biotechnology and medical devices, and allied products companies in Puerto Rico, the United States and Europe. Our team includes more than 300 experienced engineering and life science professionals, and includes former quality assurance managers and directors, and experienced and trained professionals with bachelors, masters and doctorate degrees in health sciences and engineering.

We actively operate in Puerto Rico, the United States, Ireland and Spain 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 professionals or dollar volume) and responding to prospective customers' requests for proposals.

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

The Lab incorporates the latest technology and test methodologies meeting pharmacopoeia industry standards and regulations. It currently offers services to our core industries already serviced as well as the cosmetic and food industries.

We also provide technical seminars/training that incorporate the latest regulatory trends and standards as well as other related areas. A network of leading industry professional experts in their field, which include resources of our own,

provide these seminars/training to the industry through our “Pharma Serv Academy” division. These services are provided in the markets we currently serve, as well as others, and position our Company as a key leader in the industry.

Our information technology services and consulting division based in Puerto Rico (“Integratek”) provide a variety of information technology services such as web pages and portals development, digital art design, intranets, extranets, software development including database integration, Windows and web applications development, software technical training and learning management systems, technology project management, and compliance consulting services, among others. Integratek is a Microsoft Certified Partner and a reseller for technology products from leading vendors in the market.

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 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.

Industry consolidations, the pharmaceutical regulatory environment, changes in tax laws, customers' price sensitive procurement processes, and the local and global economies recession continue to be factors and uncertainties that affect our business. As such, we are constantly realigning our business strategies as new opportunities and challenges arise.

For the three months ended January 31, 2014, net revenues for the Company were \$7.0 million, a decrease of \$0.6 million, or 8% when compared to the same period last year. This decline is mainly attributable to a \$0.4 and \$0.2 million revenue decrease in the United States and Europe consulting markets, respectively. Other Company divisions sustained minor revenue gains/losses or remained constant, when compared to the same period last year. The Company continues to invest in its business development and operational support expenses for all its divisions in order to diversify their market and customer base.

The revenue decline, combined with an investment increase in business development and operational support expenses, have led our three months ended January 31, 2014 net income to be approximately \$0.7 million, a decrease of \$0.4 million, when compared with the same period last year.

The following table sets forth information as to our revenue for the three-month periods ended January 31, 2014 and 2013, by geographic regions (dollars in thousands).

Revenues by Region:	Three months ended January 31,					
	2014			2013		
Puerto Rico	\$4,003	57.1	%	\$4,050	52.9	%
United States	2,321	33.1	%	2,749	35.9	%
Europe	683	9.8	%	855	11.2	%
	\$7,007			\$7,654		

Weak economies where we do business and worldwide industry consolidations will continue to be unfavorable factors going forward. These factors, and the impact on the industry, if any, of the enacted U.S. health care reform (Patient Protection and Affordable Care Act) and Puerto Rico Act 154, which imposed temporary excise taxes, and was extended through December 2017, to the industry we serve, remain as industry uncertainties that might adversely affect our future performance. We believe that our future profitability and liquidity will be highly dependent on the effect the global economy, changes in tax laws and worldwide lifescience manufacturing industry consolidations will have over our operations, and our ability to seek service opportunities and adapt to the current industry trends.

Results of Operations