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

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended July 31, 2008

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

For the transition period from ____________ to ____________

Commission File No. 000-50956

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

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

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

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

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

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

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

PHARMA-BIO SERV, INC.

FORM 10-QSB

FOR THE QUARTER ENDED JULY 31, 2008

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

ASSETS:		
Current assets		
Cash and cash equivalents	$	2,207,077
Accounts receivable		4,100,799
Other		232,882
Total current assets		6,540,758
Property and equipment		1,555,205
Other assets, mainly intangible assets		80,625
Total assets	$	8,176,588
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities		
Current portion-obligations under capital leases	$	50,285
Accounts payable and accrued expenses		1,330,407
Due to affiliate		2,661,531
Income taxes payable		246,000
Total current liabilities		4,288,223
Long-term liabilities		91,072
Total liabilities		4,379,295
Stockholders' equity:		
Preferred Stock, $0.0001 par value; authorized 10,000,000 shares; none outstanding		-
Common Stock, $0.0001 par value; authorized 50,000,000 shares; issued and outstanding 20,751,215 shares		2,075
Additional paid-in capital		615,123
Retained earnings		3,189,049
Accumulated other comprehensive loss		(8,954)
Total stockholders' equity		3,797,293
Total liabilities and stockholders' equity	$	8,176,588

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

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

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Pharma-Bio Serv, Inc. ("Pharma-Bio") is a Delaware corporation organized on January 14, 2004. Pharma-Bio is the parent company of Pharma-Bio Serv PR, Inc. ("Pharma-PR"), a Puerto Rico corporation, Pharma-Bio Serv US, Inc. ("Pharma-US"), a Delaware corporation, and Pharma-Bio Serv Validation & Compliance Limited ("Pharma-IR"), a majority owned Irish corporation. Pharma-Bio, Pharma-PR, Pharma-US and Pharma-IR are collectively referred to as the "Company." The Company operates in Puerto Rico, the United States and in Ireland under the name of Pharma-Bio Serv and is engaged in providing technical compliance consulting services primarily to the pharmaceutical, chemical, medical device and biotechnology industries.

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Consolidation

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

Use of Estimates

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

Fair Value of Financial Instruments

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

Revenue Recognition

Revenue is primarily derived from: (1) time and materials contracts (representing approximately 90% of total revenues), which is recognized by applying the proportional performance model, whereby revenue is recognized as performance occurs, and (2) short-term fixed-fee contracts or "not to exceed" contracts (representing approximately 10% of total revenues), which revenue is recognized similarly, except that certain milestones also have to be reached before revenue is recognized. If the Company determines that a fixed-fee or “not to exceed” contract will result in a loss, the Company recognizes the estimated loss in the period in which such determination is made.

Cash Equivalents

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

Accounts Receivable

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

Income Taxes

The Company follows the provisions of Statement of Financial Accounting Standards Board No. 109, "Accounting for Income Taxes," which requires an asset and liability approach method of accounting for income taxes. This method measures deferred income taxes by applying enacted statutory rates in effect at the balance sheet date to the differences between the tax basis of assets and liabilities and their reported amounts on the financial statements. The resulting deferred tax assets or liabilities are adjusted to reflect changes in tax laws as they occur. A valuation allowance is provided when it is more likely than not that a deferred tax asset will not be realized.

Property and equipment

Owned property and equipment, and leasehold improvements are stated at cost. Equipment and vehicles under capital leases are stated at the lower of fair market value or net present value of the minimum lease payments at the inception of the leases.

Depreciation and amortization of owned assets are provided for, when placed in service, in amount sufficient to relate the cost of depreciable assets to operations over their estimated service lives, using straight-line basis. Assets under capital leases and leasehold improvements are amortized, over the shorter of the estimated useful lives of the assets or lease term. Major renewals and betterments that extend the life of the assets are capitalized, while expenditures for repairs and maintenance are expensed when incurred.

The Company evaluates for impairment its long-lived assets to be held and used, and long-lived assets to be disposed of, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Based on management estimates, no impairment of the operating properties was present.

Intangible assets

Definite-lived intangible assets, such as customer lists and covenants not to compete, are amortized on a straight-line basis over their estimated useful lives. The Company continually evaluates the reasonableness of the useful lives of these assets.

Stock-based Compensation

Effective November 1, 2006, the Company adopted the provisions of SFAS No. 123R, “Share-Based Payment” (“SFAS 123R”), and Staff Accounting Bulletin No. 107 (“SAB 107”) using the modified prospective method, which results in the provisions of SFAS 123R being applied to the consolidated financial statements on a prospective basis. Under the modified prospective recognition method, restatement of consolidated income from prior periods is not required, and accordingly, the Company has not provided such restatements. Under the modified prospective provisions of SFAS 123R, compensation expense is recorded for the unvested portion of previously granted awards that were outstanding on November 1, 2006 and all subsequent awards. SFAS 123R requires that all stock-based compensation expense be recognized in the consolidated financial statements based on the fair value of the awards. Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of awards that will be forfeited. The Company calculates the fair value of stock options using the Black-Scholes option-pricing model at grant date. SFAS 123R also amends SFAS No. 95, “Statement of Cash Flows”, to require that excess tax benefits related to stock-based compensation be reflected as cash flows from financing activities rather than cash flows from operating activities. The Company does not recognize such cash flow from financing activities since there has been no tax benefit related to the stock-based compensation.

Income Per Share of Common Stock

Basic income per share of common stock is calculated dividing net income by the weighted average number of shares of common stock outstanding. Diluted income per share includes the dilution of common stock equivalents.

The diluted weighted average shares of common stock outstanding were calculated using the treasury stock method for the respective periods.

Foreign Operations

The functional currency of the Company’s foreign subsidiary is its local currency. The assets and liabilities of the Company’s foreign subsidiary are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. The cumulative translation effect for subsidiaries using a functional currency other than the U.S. dollar is included as a cumulative translation adjustment in stockholders’ equity and as a component of comprehensive income.

The Company’s intercompany accounts are typically denominated in the functional currency of the foreign subsidiary. Gains and losses resulting from the remeasurement of intercompany receivables that the Company considers to be of a long-term investment nature are recorded as a cumulative translation adjustment in stockholders’ equity and as a component of comprehensive income, while gains and losses resulting from the remeasurement of intercompany receivables from those international subsidiaries for which the Company anticipates settlement in the foreseeable future are recorded in the consolidated statements of operations. The net gains and losses recorded in the condensed consolidated statements of income were not significant for the periods presented.

Reclassifications

Certain reclassifications have been made to the July 31, 2007 interim condensed consolidated financial statements to conform them to the July 31, 2008 interim condensed consolidated financial statements presentation. Such reclassifications do not have a material effect on net income as previously reported.

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

1. In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, *Business Combinations (*"SFAS 141R"). SFAS 141R requires: the assets acquired and liabilities assumed to be measured at fair value as of the acquisition date; liabilities related to contingent consideration to be remeasured at fair value at each subsequent reporting period; and acquisition-related costs to be expensed as these are incurred. SFAS 141R also requires additional disclosures of information surrounding a business combination. The provisions of SFAS 141R are effective for fiscal years beginning on or after December 15, 2008 and apply to business combinations that are completed on or after the date of adoption. The Company has not yet adopted this pronouncement, but expects that the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions the Company completes after the effective date, if any.

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

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

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

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

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

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

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

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

NOTE C - PROPERTY AND EQUIPMENT

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

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

NOTE D - OTHER ASSETS

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

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

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

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

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

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NOTE E - LINE-OF-CREDIT

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

NOTE F - INCOME TAXES

On July 2008, Pharma-Bio and Pharma-PR obtained a Grant of Industrial Tax Exemption ("the Grant") from the Puerto Rico Industrial Development Company pursuant to the terms and conditions set forth in Act No. 135 of December 2, 1997, as amended. The Grant provides relief on various Puerto Rico taxes, including income tax, mostly for the Company's new microbiological testing facility and service activities outside of Puerto Rico. The Grant is effective as of September 1, 2007 and covers a ten year period. Activities covered by the Grant are subject to a reduced income tax rate of 7%.

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

The operations carried out in the United States by the Company's subsidiary are taxed in the United States. With certain limitations, the Company receives a credit on its Puerto Rico tax for the federal income tax paid. Also, upon distribution of earnings by the Puerto Rican subsidiary to its parent those dividends are taxed at the federal level, however, the parent is able to receive a credit for the taxes paid by the subsidiary on its operations in Puerto Rico, to the extent of the federal taxes that result from those earnings (determined at rates which are normally lower than in Puerto Rico). As a result, the income tax expense of the Company, under its present corporate structure, would normally be the Puerto Rico taxes on operations in Puerto Rico, plus 10% withholding in Puerto Rico from dividends paid to the Puerto Rican subsidiary's parent, plus federal taxes on operations in the United States.

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

As of July 31, 2008, the Company has not recognized deferred income taxes on $3,393,976 of undistributed earnings of its Puerto Rican subsidiary, since such earnings are considered to be reinvested indefinitely. If the earnings were distributed in the form of dividends, the Company would be subject to a $339,397 tollgate tax.

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

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

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

NOTE G - DUE TO AFFILIATE

Pursuant to a plan and agreement of merger dated January 25, 2006, the Company agreed to pay its then sole stockholder of Pharma-PR three installments of $2,750,000 on January 25, 2007, 2008 and 2009, including imputed interest. As of July 31, 2008 two installments were paid.

Outstanding installment as of July 31, 2008:

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

NOTE H - LEASE COMMITMENTS

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

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

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

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

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

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

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

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

		Amount
2009	$	255,356
2010		268,064
2011		266,977
2012		136,744
Total minimum lease payments	$	927,141

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

NOTE I - STOCK OPTIONS AND STOCK BASED COMPENSATION

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

Effective November 1, 2006, the Company adopted the provisions of SFAS No.123R, “Share-Based Payment” (“SFAS 123R”), and S.E.C. Staff Accounting Bulletin No. 107 (“SAB 107”). The Company recognizes stock-based compensation based on the fair value of the awards. Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of awards that will be forfeited.

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The following table presents the stock-based compensation included in the Company's consolidated statement of income:

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

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

NOTE J – WARRANTS

At July 31, 2008 the Company had outstanding warrants to purchase 11,053,216 shares of the Company's common stock at prices ranging from $0.06 to $1.65 per share. The warrants became exercisable at various dates commencing in 2004 and expire at various dates through 2014.

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

NOTE K – EARNINGS PER SHARE

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

	Three months ended July 31,	Nine months ended