Zacks Small-Cap Research

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Pharma-Bio Serv (PBSV-OTC)

PBSV: Positive Cash Flow, Trading Below Book Value, Opportune Time to Buy the Stock

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	09/15/2013
Current Price (03/23/16)	$0.77
Target Price	**$2.00**

OUTLOOK

Regularly recognized as one of the top validation companies in Puerto Rico, PBSV is principally engaged in providing compliance consulting to the pharmaceutical industry. Serving customers in the U.S., Europe, and Puerto Rico, PBSV counts many of the pharma "majors" as clients. The company's small size, high levels of expertise in various disciplines and reputation as an eminent life sciences consulting firm has allowed it to adapt to and capitalize on the changing regulatory landscape.. While revenue has slipped recently we attribute this mostly to macro-economic weakness and think PBSV returns to growth over the short-term, facilitated by investments in infrastructure, personnel and entry into new markets.. And despite revenue falling recently, cash flow generation has remained robust and the company remains highly profitable. Company has a stellar balance sheet with tons of cash which they are now looking to reinvest in the business. New catalysts emerging which could pay dividends in short-order. Trading below book value offers opportune time to buy the stock.

SUMMARY DATA

52-Week High	**$1.30**
52-Week Low	**$0.65**
One-Year Return (%)	**-34.78**
Beta	**-0.13**
Average Daily Volume (sh)	**5,010**
Shares Outstanding (mil)	**23**
Market Capitalization ($mil)	**$17**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**43**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**6.1**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**11.0**
P/E using 2016 Estimate	**25.7**
P/E using 2017 Estimate	**11.0**
Zacks Rank	**N/A**

Risk Level	**Average,**
Type of Stock	**Small-Value**
Industry	**Consulting**

ZACKS ESTIMATES

Revenue
(in millions)

	Q1 (Jan)	Q2 (Apr)	Q3 (Jul)	Q4 (Oct)	Year (Oct)
2015	$5.9 A	$5.4 A	$6.2 A	$5.9 A	$23.4 A
2016	$4.9 A	$5.2 E	$5.9 E	$6.0 E	$21.9 E
2017					$25.3 E
2018					$28.5 E

Earnings per Share

	Q1 (Jan)	Q2 (Apr)	Q3 (Jul)	Q4 (Oct)	Year (Oct)
2015	$0.01 A	$0.02 A	$0.02 A	$0.02 A	$0.07 A
2016	$0.02 A	$0.01 E	$0.01 E	$0.00 E	$0.03 E
2017					$0.07 E
2018					$0.11 E

Zacks Projected EPS Growth Rate - Next 4 Years % **18**

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Fiscal Q1 2016 Results: *Still Churning Positive Cash Flow. Shares Trading Well Below Book Value. Opportune Time to Buy the Stock…*

PBSV reported financial results for the first fiscal quarter ending January 31, 2016. While revenue remained less than exciting with every itemized revenue segment contracting from the comparable prior year period save lab testing, a relatively beefy gross and somewhat tempered operating expenses resulted in very respectable net income, EPS and operating cash flow. Q1 results, where revenue fell almost 17% yoy but gross margin and operating margin increased almost 600 basis points and over 200 basis points, respectively, over that same period, highlights the uniqueness in PBSV's cost structure. This highly variable cost structure has afforded the company the ability to continue to generate positive cash flow even in times of declining revenues.

And the most recent quarter is not a flash-in-the-pan in that regard. While revenue declined from $33M in fiscal 2013 (October 2013) to $28M (-17%) in 2014 to $23M (-15%) in 2015 and fell 17% (from $5.9M to $4.9M) in the most recent quarter, cash balance increased from $12M at the end of 2013 to almost $15M at the end of Q1 2016. And not only did PBSV not raise any capital over that period of time, but to the contrary, they made over $900k in capital purchases (i.e. – reinvestments in the business) and repurchased almost $216k worth of common stock – both of which are aimed at increasing shareholder value for the long-term. These are reasons for investor to be interested in PBSV.

And the company is looking to restart revenue growth by putting some of their cash balance to work, noting in the last two quarterly SEC filings that, "We are constantly realigning our business strategies to grow our business. As such, the Company management understands that planned infrastructure investments on human capital, new markets, and Lab facilities and equipment during fiscal year 2016 will provide sustainable growth to the Company in future years. For the year ended October 31, 2016, the Company intends to invest approximately (i) $1.7 million on new business development positions on consulting targeted new markets, and (ii) $2.0 million for the expansion of our Puerto Rico Lab facilities, openings of a Lab facility in Spain and the Calibrations division facility in Puerto Rico. The Company's working capital will be used to fund these investments"

As a reminder PBSV recently formed a new PR-based Calibrations division called Metrologix – while the company had previously expected this to be operational by October 2015, based on the language above, it appears this timeline has slipped. And in April 2015 PBSV formed Pharma-Brazil, a wholly-owned subsidiary which will provide consulting services to the Brazilian market. Pharma-Brazil still remains in the development stage but offers another potential opportunity to contribute to revenue in future periods. Given the recent strength in Latin America-related project demand and revenue, this area of the world, including Brazil, could offer meaningful growth opportunity for PBSV.

And despite the recent consistent yoy contraction in revenue, PBSV continues to remain in the black. But while top-line growth has stalled there are reasons to remain interested in PBSV – including reinvestments and new segments expected to come online which are expected to reignite sales growth, ongoing positive cash flow generation and increasing book value. In fact the stock currently trades at about a 20% discount to book value – which, based on the company's history of generating positive cash flow and increasing its book value, presents what we believe to be a particularly opportune time to buy the shares. And PBSV had previously noted the possibility of an acquisition (in December 2014 PBSV engaged a firm to explore M&A opportunities) – if it were to happen, this could be another catalyst for growth.

Q1 revenue was $4.9 million, down 17% yoy, down 17% sequentially and 17% lower than our $5.9 million estimate. As has been the case for the past several quarters, U.S. and European sales remained tepid. U.S. consulting revenue fell on a yoy basis by 57%, while European consulting revenue fell 51%. U.S. had accounted for 28% of total revenue in fiscal 2014 – this fell to 12% in 2015 and just 7% in the most recent quarter – which represents the bulk of the contraction in total company revenue over those periods. Europe has been similarly soft, although not as important a territory as the U.S. (Europe accounts for just 4% - 5% of total revenue). As a reminder, the bulk of European revenue has related to just one customer in Ireland and declining European revenue relates to loss of project headcount related to this customer. Puerto Rico consulting (most notably projects in Latin America managed in PR) has been one of the only bright spots in the consulting segment - with revenue growing 12% in 2015, although slipping about 16% in Q1 of fiscal 2016. Puerto Rico consulting now accounts for over 70% of total revenue, up from 57% in 2014. But the most significant recent highlight has been with the Lab testing segment, which is currently all based in Puerto Rico. Lab testing revenue grew 17% in 2015 and almost 80% in Q1 2016. This represents perhaps the most significant near-term growth opportunity as PBSV expects to pump ~$2M into expansion of the P.R. lab, opening of a lab in Spain and starting the Calibrations

division (in P.R.). The other benefit that could come with increasing Lab-related revenue is beefier margins – PBSV noted that the relatively wide 36% gross margin in Q1 was largely related to an increase in lab testing volume.

And as we have noted in the past, a higher percentage of revenue from PR has tax benefits as revenue generated in that territory is taxed at just 4% (as a result of the company's beneficial PR tax status), compared to a maximum regular federal income tax rate of 35% for U.S. operations. This is highlighted in the aggregate income tax rate, which fell from 16% in 2014 (when PR and U.S. revenue accounted for 57% and 28% of total sales, respectively) to just 9% in 2015 (when PR and U.S. revenue accounted for 75% and 12% of total sales, respectively). So, the shift in geographic revenue mix essentially added almost $119k, or about 8% more to net income in 2015.

Gross margin was a highlight in Q1. At 35.9% it was the highest since Q4 2013, well ahead of the 29% in Q1 2015 and 32% for the full year in 2015. OpEx was $1.4M and below our $1.7M estimate – the difference due to our expectation that some of the aforementioned investments in human capital would show up in the quarter. PBSV is guiding for $1.7M in additional expense during 2016 related to the build-out of new business development positions related to new markets. While we expect revenue to benefit incrementally from these investments during 2016, we model a more substantive contribution in 2017 and beyond when we expect the additional operating expenses to be more fully absorbed.

Q1 net income and EPS were $350k and $0.02, ahead of our $190k and $0.01 estimates. Despite the yoy contraction in revenue over the last nine consecutive quarters PBSV continues to generate both positive net income and cash flow. Cash flow from operations was $72k in Q1 and was $446k excluding changes in working capital. The company exited the quarter with $14.5 million in cash and securities.

Valuation / Recommendation

Based on our model we look for EPS to grow at a 3-year CAGR of about 15% through 2019. We use an industry PE/G ratio of 1.7x to value PBSV. We look for 2017 EPS of $0.07 which values the company at approximately $2.00/share. The stock currently trades at about $0.77, indicating the shares are trading cheaper than fair value.

We also note that book value (as of January 31, 2016) is ~$22 million or about 1.3x that of current market value. We think book value should provide a floor on the stock. PBSV has a long history of cash flow generation, which has continued during the recent slide in revenue. So we think it is reasonable to expect book value to continue to grow, raising this floor and further reducing any downside risk. We recommend accumulating up to our $2.00/share price target. We are maintaining our Buy rating.

FINANCIAL MODEL

Pharma-Bio Serv, Inc

	2015 E	Q1A	Q2E	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Total Revenues	$23,384.9	$4,900.5	$5,208.9	$5,879.2	$5,928.7	$21,917.2	$25,264.0	$28,516.7	$31,799.1
YOY Growth	*-15.1%*	*-16.7%*	*-4.3%*	*-4.9%*	*0.9%*	*-6.3%*	*15.3%*	*12.9%*	*11.5%*
Cost of Services	$15,900.4	$3,142.1	$3,437.9	$3,909.6	$3,972.2	$14,461.8	$16,977.4	$18,792.5	$20,669.4
Gross Income	$7,484.5	$1,758.4	$1,771.0	$1,969.5	$1,956.5	$7,455.4	$8,286.6	$9,724.2	$11,129.7
Gross Margin	*32.0%*	*35.9%*	*34.0%*	*33.5%*	*33.0%*	*34.0%*	*32.8%*	*34.1%*	*35.0%*
SG&A	$5,703.1	$1,374.2	$1,614.8	$1,822.5	$1,837.9	$6,649.4	$6,695.0	$7,157.7	$7,472.8
% SG&A	*24.4%*	*28.0%*	*31.0%*	*31.0%*	*31.0%*	*30.3%*	*26.5%*	*25.1%*	*23.5%*
Operating Income	$1,781.3	$384.1	$156.3	$147.0	$118.6	$806.0	$1,591.6	$2,566.5	$3,656.9
Operating Margin	*7.6%*	*7.8%*	*3.0%*	*2.5%*	*2.0%*	*3.7%*	*6.3%*	*9.0%*	*11.5%*
Total Other Income (Expense)	$11.5	($2.7)	($1.0)	($1.2)	$1.0	($3.9)	$8.0	$22.0	$22.0
Pre-Tax Income	$1,792.8	$381.4	$155.3	$145.8	$119.6	$802.1	$1,599.6	$2,588.5	$3,678.9
Tax expense (benefit)	$168.0	$31.4	$12.7	$12.1	$9.9	$66.2	$182.4	$321.0	$463.5
Tax Rate	*9.4%*	*8.2%*	*8.2%*	*8.3%*	*8.3%*	*8.3%*	*11.4%*	*12.4%*	*12.6%*
Net Income	$1,624.8	$350.0	$142.5	$133.7	$109.6	$735.9	$1,417.3	$2,267.5	$3,215.4
YOY Growth	*-32.2%*	*21.4%*	*-60.3%*	*-70.6%*	*-79.1%*	*-54.7%*	*92.6%*	*60.0%*	*41.8%*
Net Margin	*6.9%*	*7.1%*	*2.7%*	*2.3%*	*1.8%*	*3.4%*	*5.6%*	*8.0%*	*10.1%*
EPS	$0.07	$0.02	$0.01	$0.01	$0.00	$0.03	$0.07	$0.11	$0.15
YOY Growth	*-31.4%*	*22.4%*	*-60.0%*	*-70.4%*	*-78.9%*	*-54.3%*	*108.0%*	*60.0%*	*43.8%*
Diluted Shares O/S	23,400	23,258	23,250	23,200	23,150	23,215	21,500	21,500	21,200

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BALANCE SHEET

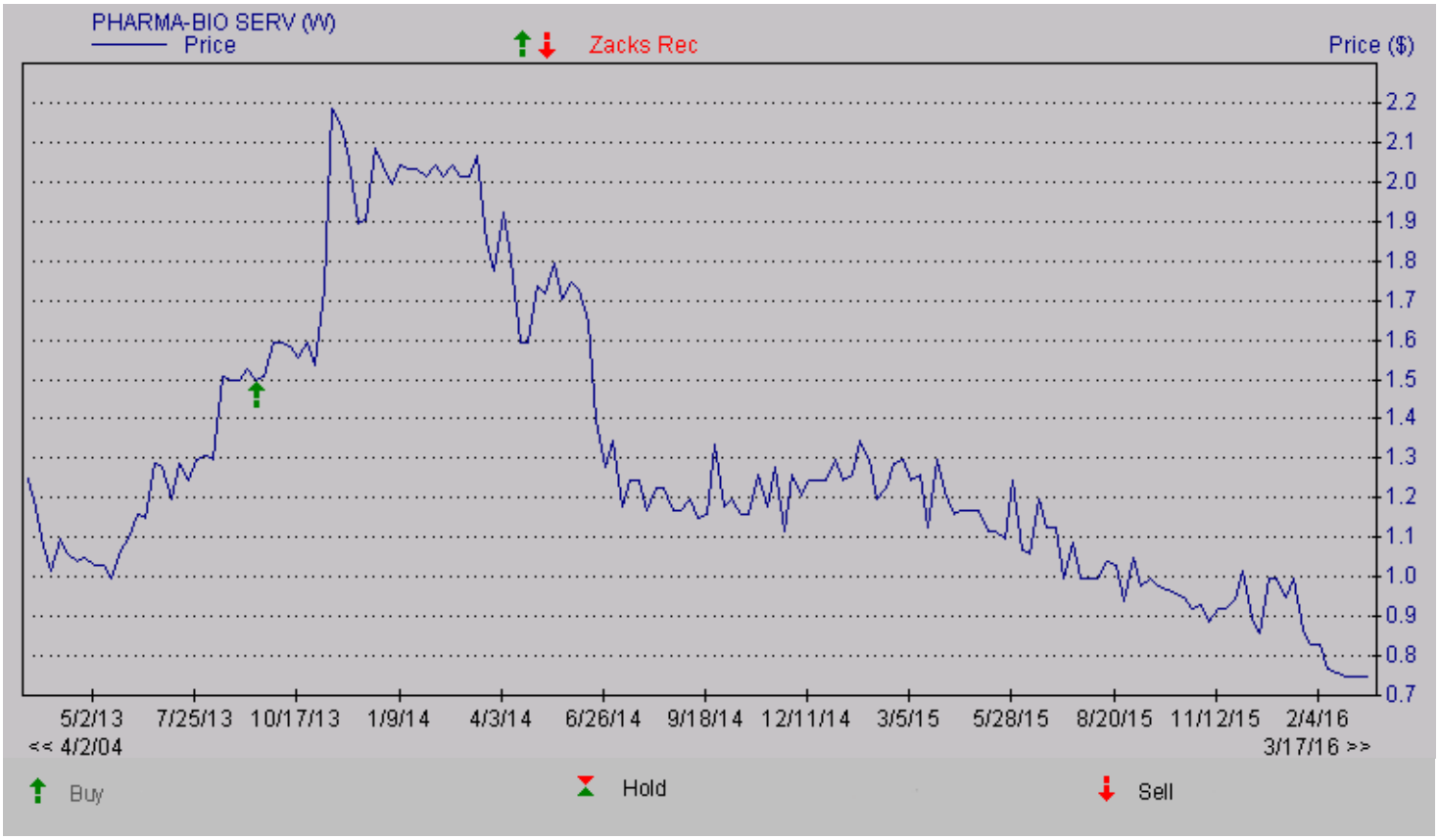
	January 31, 2016	October 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,516	$ 14,898
Marketable Securities	27	33
Accounts Receivable	7,362	7,448
Other	720	892
Total current assets	22,624	23,267
Property and equipment, net	1,194	854
Other assets	18	18
Total assets	$ 23,836	$ 24,139
LIABILITIES		
Current liabilities:		
Current portion-obligations under capital lease	$ 23	$ 23
Accounts payable and accrued expenses	1,404	2,062
Income taxes payable	68	39
Total current liabilities	1,495	2,124
Obligations under capital leases	46	52
Total liabilites	1,541	2,176
STOCKHOLDERS' EQUITY		
Preferred Stock	-	-
Common stock	2	2
Additional paid-in capital	1,165	1,143
Retained earnings	21,582	21,232
Accumulated other comprehensive loss	(238)	(227)
Total stockholders' equity	22,295	21,963
Total liabilities and stockholders' equity	$ 23,836	$ 24,139

CASH FLOW STATEMENT

	Three months January 31, 2016	2015
Cash flows from operating activities:		
Net income	$ 350	288
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposition of P&E	-	-
Stock-based compensation	22	21
Depreciation and amortization	74	91
Changes in operating assets and liabilities:		
Accounts receivable	82	144
Other assets	171	63
Liabilities	(627)	(490)
Net cash provided by operating activities	72	118
Cash flows from investing activities:		
Acquisition of P&E	(414)	(35)
Proceeds from disposition of P&E	-	-
Net cash used in investing activities	(414)	(35)
Cash flows from financing activities:		
Proceeds from common stock issuance	-	-
Repurchase of common stock	(29)	(87)
Payments on obligations under capital lease	(6)	(6)
Net cash provided by (used in) financing activities	(35)	(93)
Effect of exchange rate changes on cash	(1)	(31)
Net increase (decrease) in cash and cash equivalents	(378)	(42)
Cash and cash equivalents, beginning of period	14,893	15,088
Cash and cash equivalents, end of period	14,516	15,046

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