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Zacks Small-Cap Research

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Pharma-Bio Serv (PBSV-OTCQB)

PBSV: New model, adjusting target

We value PBSV at $2.11 per share, up from our previous target of $1.95. Our previous valuation was based on a 12x multiple applied to our 2021 estimate. Our new target is based on a 10-year DCF with an 18% terminal EBIT margin and an 11% discount rate. The shares trade barely higher than book value, which we think will continue to be supported by cash flow generation and positive ROI acting as a floor on the share price.

OUTLOOK

We believe that after a post-COVID slow start to 2021, Pharma-Bio Serv will build on the strong progress of 2020 over the next three years. With stable profit margins, $19 million cash on the balance sheet, regular payouts to shareholders in the past three years yielding over 6% annually, and myriad opportunities to expand their focus beyond pharmaceutical manufacturers, we believe Pharma-Bio Serv is a unique opportunity for value-oriented investors.

Current Price (05/17/21)	$1.23
Valuation	**$2.11**

SUMMARY DATA

52-Week High	**$2.34**
52-Week Low	**$0.82**
One-Year Return (%)	**44.71**
Beta	**0.19**
Average Daily Volume (sh)	**3,098**
Shares Outstanding (mil)	**23**
Market Capitalization ($mil)	**$29**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**12**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**2.7**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**15.4**
P/E using 2021 Estimate	**7.7**
P/E using 2022 Estimate	**6.2**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Value**
Industry	**Consulting**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Jan)	Q2 (Apr)	Q3 (Jul)	Q4 (Oct)	Year (Oct)
2019	5 A	5 A	5 A	5 A	20 A
2020	5 A	6 A	6 A	5 A	22 A
2021	4 A				20 E
2022					23 E

Earnings per share

	Q1 (Jan)	Q2 (Apr)	Q3 (Jul)	Q4 (Oct)	Year (Oct)
2019	$0.02 A	$0.03 A	$0.02 A	$0.02 A	$0.09 A
2020	$0.02 A	$0.03 A	$0.03 A	$0.01 A	$0.09 A
2021	$0.01 A				$0.07 E
2022					$0.10 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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COMPANY UPDATE

We've enhanced our financial forecast and valuation models to provide additional clarity into our estimates and opportunities for Pharma-Bio Serv. Based on our belief that revenue growth will accelerate over the next few years, we are raising our target price from $1.95 to $2.11.

Pharma-Bio Serv has a well-established business model serving an industry with complex, specific needs. New contracts are generally won through a competitive bid process and generally go to companies with an established reputation for delivering high quality, reliable and timely solutions.

The Company's has emphasized organic growth in Puerto Rico and increasingly in other geographies. In addition, the Company looks to provide GMP services outside its core pharmaceutical client base, such as food, cosmetic and automotive manufacturers. Any additional investments the Company makes in its business and the rate of its expansion will factor significantly in both our forecasts and financial valuation.

We are confident that while FY2021 is off to a slow start, the Company will post accelerating top-line growth over the next two to three years driven by economic recovery, revived interest in on-shoring pharmaceutical manufacturing in the US and the strong likelihood of renewed emphasis on regulatory compliance under a democratic administration.

In February, Invest Puerto Rico (InvestPR), a local economic development organization, announced CytoImmune Therapeutics, Inc. and Biosimilar Solutions, LLC, will move operations to the island bringing an estimated 300-400 new jobs. We see this as a small, but positive signal towards our hypothesis.

VALUATION

We have reconsidered our valuation of Pharma-Bio Serv, moving from a P/E-based methodology to a DCF. For us, the P/E methodology falls short in terms of meaningful, publicly-traded peers and also doesn't illustrate the Company's strong, consistent cash flows, frequent dividend payouts and ability to grow without the need for new working investment.

Exhibit 1: Valuation sensitivity

WACC	Terminal EBIT Margin				
	14.18%	14%	16%	18%	20%	22%
8%		2.22	2.34	2.46	2.59	2.71
9%		2.10	2.21	2.31	2.42	2.53
10%		2.01	2.11	2.20	2.29	2.39
11%		1.94	2.03	**2.11**	2.20	2.28
12%		1.89	1.97	2.04	2.12	2.19
13%		1.84	1.91	1.98	2.05	2.12
14%		1.81	1.87	1.93	2.00	2.06

Source: Company filings. Zacks Investment Research estimates.

Our 10-year DCF model builds to sales of approximately $47m by 2031. We model terminal sales with an EBIT margin of 18% and a 15% tax rate. We assume a terminal growth rate of 2% and an 11% discount rate. Under these assumptions, we arrive at an intrinsic value of $2.11 per share, compared with our previous estimate of $1.95. Notably, our model includes an estimated annual payout to shareholders of $0.07 per share, consistent with payouts in recent years.

Trends in the pharmaceutical industry affect Pharma-Bio Serv's growth. A decade ago, the Company generated about half its revenues (c. $15-16 million at the time) in the US and EU. However, in 2011-2012, a number of blockbuster drugs came off patent resulting in plant closures and a shift to manufacturing in Asia, leading to a decline in business for many pharmaceutical consultants.

In FY2020, Puerto Rico accounted for 84% of total consulting revenues, with 10% coming from the US and the balance evenly split between customers from the EU and Brazil. We forecast top-line growth of 9% for the Company through 2031. We look for high single-digit growth in Puerto Rico, augmented by 10-15% revenue growth in expansion markets.

We model gross margins in the 30-31% range, although contracts outside Puerto Rico can be more profitable in some cases. Project staffing as the Company's primary expense and is largely variable, so margin expansion will come primarily through leveraging SG&A.

FINANCIALS

Pharma-Bio Serv is well funded with a solid business strategy, expanding geographic presence and strong experienced management team. We expect that the Company will invest and manage with the long-term in mind, resulting in consistent and sustainable results for investors.

Profit and loss

Pharma-Bio Serv concluded a challenging FY20 with solid results. Revenues rose 11% to $21.6 million from $19.6 million in FY19. Revenue growth was up across all geographies, led by a 163% increase in Europe to $0.83 million. Sales in Puerto Rico rose 8%, while US business increased 10% and Brazil revenues 15% to $0.24 million. It's important to note, however that as a project-based business, quarterly results can be volatile as contracts roll on or roll off.

Gross profit margins declined slightly to 30% from 31% in the year-earlier period, reflecting higher growth in smaller geographies.

SG&A declined 1% to $4.4 million compared with $4.5 million in the year-earlier period and declined as a percent of revenue to 20.6% from 22.9%.

These minor changes led to a 31% gain in operating income to $2.2 million, from $1.7 million a year ago. Higher taxes and lower other income kept net income was roughly flat year to year at $2.1 million, and $0.09 per share.

In its fiscal quarter, ended Jan 31, 2021, PBSV posted revenues of $4.5 million, down $0.13 million from the year earlier period. Net income in the quarter totaled $0.27 million, largely stable from the year

earlier period. The Company attributed the decline to the end of several projects and a slower start to post-COVID regulatory implementations.

Covid is having a somewhat longer impact on PBSV's business than we originally anticipated. Consulting clients have focused on vaccine production, and it will probably be later in 2021 before new production regulations are finalized and implemented. For fiscal 2021, we look for revenues of $20.3 million, down from our previous estimate of $23.5 million. We expect gross margins to expand slightly to 31% and SG&A be largely unchanged at $4.5 million (22% of revenues). Earnings per share are expected to come in around $0.07.

For fiscal 2022, we anticipate revenues of $23 million, up 13%, gross margins of 30-31%, SG&A again largely unchanged at $4.6 million and earnings per share of $0.10.

Cash flow

Pharma-Bio Serv's business model is not capital intensive. The Company has posted positive cash flow from continuing operations in recent years, and its key use of cash from operations is for accounts receivable. Our model has sales sensitive working investment of $0.9 million for fiscal 2021, climbing to $1.5 million in fiscal 2023, driven entirely by anticipated growth in accounts receivable.

Balance Sheet

At January 31, PBSV had $19 million in cash and equivalents on its balance sheet, up from $17.1 million at the end of fiscal 2020. Much of the gain came from the receipt of a $1.25 million promissory note tied to the sale of the lab business in 2018.

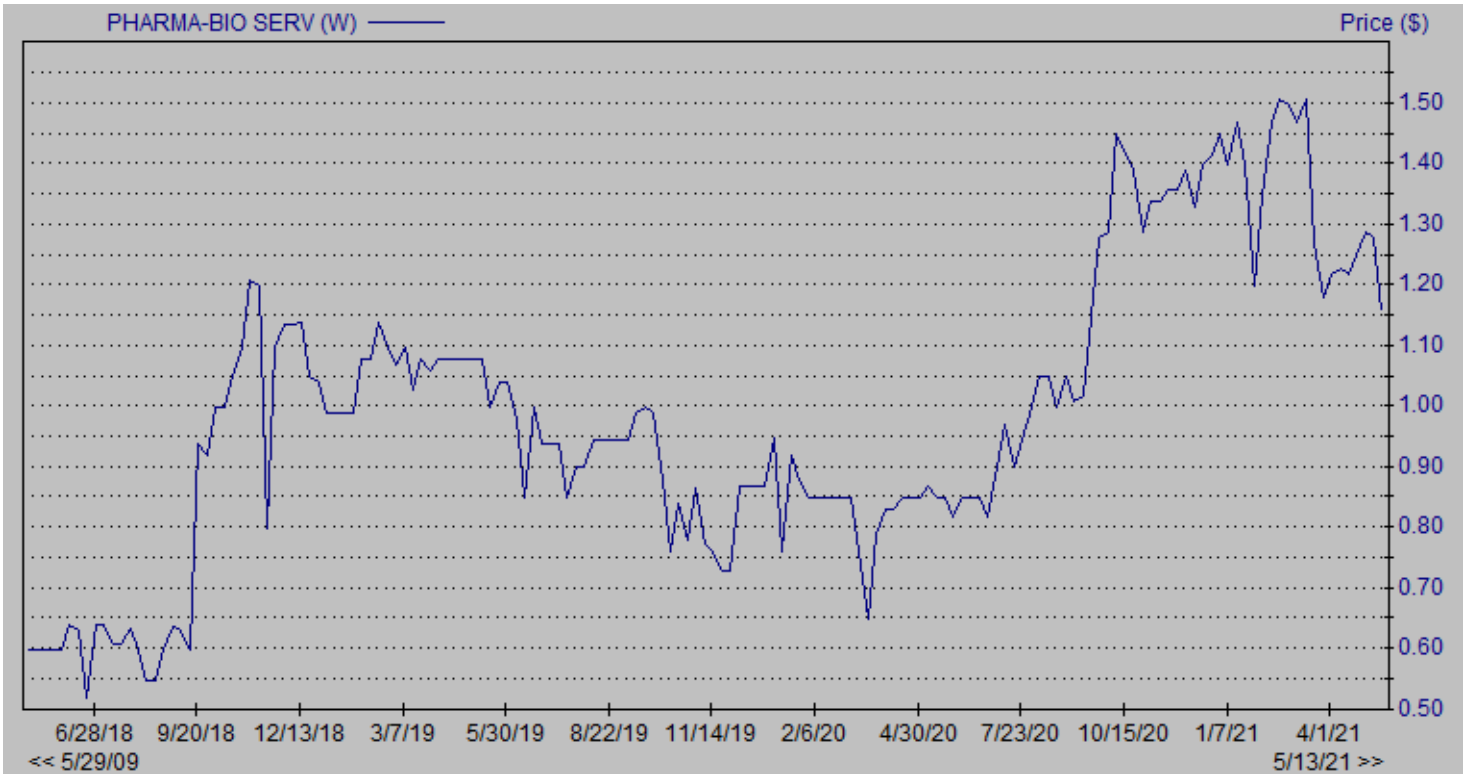
Exhibit 2: Financial summary

INCOME STATEMENT								
Fiscal year (Oct)	2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E
Revenue	19,506,911	21,564,360	20,319,054	22,896,630	25,438,214	27,816,949	30,196,233	32,543,221
Cost of sales	(13,330,295)	(14,897,638)	(14,020,147)	(15,798,674)	(17,679,559)	(19,193,695)	(20,835,401)	(22,454,823)
Gross Profit	6,176,616	6,666,722	6,298,907	7,097,955	7,758,655	8,623,254	9,360,832	10,088,399
Selling, general & administrative	(4,479,933)	(4,441,175)	(4,529,999)	(4,665,898)	(4,805,875)	(4,950,052)	(5,098,553)	(5,302,495)
Operating profit (EBIT)	1,696,683	2,225,547	1,768,908	2,432,057	2,952,780	3,673,203	4,262,279	4,785,903
Total other income/(expense)	526,567	64,463	65,752	67,067	68,409	69,777	71,172	72,596
Pretax profit	2,223,250	2,290,010	1,834,660	2,499,124	3,021,189	3,742,979	4,333,451	4,858,499
Taxes	(135,994)	(239,088)	(201,813)	(274,904)	(347,437)	(449,158)	(520,014)	(607,312)
Net income	2,087,256	2,050,922	1,632,848	2,224,220	2,673,752	3,293,822	3,813,437	4,251,187
Basic shares outstanding	23,054,653	23,003,327	23,405,753	23,405,753	23,405,753	23,405,753	23,405,753	23,405,753
Diluted shares outstanding	23,113,857	23,040,075	23,405,753	23,405,753	23,405,753	23,405,753	23,405,753	23,405,753
Basic EPS	$0.09	$0.09	$0.07	$0.10	$0.11	$0.14	$0.16	$0.18
Diluted EPS	$0.09	$0.09	$0.07	$0.10	$0.11	$0.14	$0.16	$0.18
EBITDA reconciliation								
Depreciation & amortization	99,095	86,283	70,000	70,000	70,000	70,000	70,000	70,000
Stock based compensation	34,120	42,878	(37,100)	(40,929)	(56,214)	(60,359)	(64,835)	(69,393)
EBITDA	1,829,898	2,354,708	1,801,808	2,461,128	2,966,566	3,682,843	4,267,444	4,786,510

BALANCE SHEET								
Fiscal year	2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E
Cash & equivalents	15,490,174	17,137,924	18,857,581	18,588,612	19,311,002	20,758,829	22,787,154	25,348,272
Accounts receivable	8,781,026	9,727,591	9,165,839	10,328,572	11,475,070	12,548,107	13,621,392	14,680,109
Total current assets	25,974,980	28,584,218	28,492,123	29,385,887	31,254,775	33,775,640	36,877,249	40,497,084
Property plant and equipment	290,658	217,572	222,572	227,572	232,572	237,572	242,572	247,572
Total Assets	26,633,075	29,918,746	29,831,651	30,730,415	32,604,303	35,130,168	38,236,777	41,861,612
Accounts payable	1,590,172	1,938,305	1,936,693	1,682,418	1,895,841	2,121,547	2,303,243	2,500,248
Total current liabilities	3,670,540	3,792,793	3,791,181	3,536,906	3,750,329	3,976,035	4,157,731	4,354,736
Total liabilities	6,025,569	7,202,085	7,200,473	6,946,198	7,159,621	7,385,327	7,567,023	7,764,028
Common stock / APIC	1,383,416	1,426,295	1,463,395	1,504,324	1,560,538	1,620,897	1,685,732	1,755,126
Retained earnings / accumulated defici	19,473,069	21,523,990	21,401,407	22,513,517	24,117,768	26,357,567	29,217,645	32,576,082
Other comprehensive income / (loss)	143,600	160,654	160,654	160,654	160,654	160,654	160,654	160,654
Total equity	20,607,506	22,716,661	22,631,178	23,784,217	25,444,682	27,744,840	30,669,753	34,097,584
Total liabilities and equity	26,633,075	29,918,746	29,831,651	30,730,415	32,604,303	35,130,168	38,236,777	41,861,612

CASH FLOW STATEMENT								
Fiscal year	2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E
Cash from operating activities	(2,207,739)	1,525,442	2,300,088	918,141	1,866,891	2,576,850	3,056,684	3,528,868
Capital expenditures	(57,379)	(55,657)	(75,000)	(75,000)	(75,000)	(75,000)	(75,000)	(75,000)
Cash from investing activities	1,836,134	(28,957)	1,175,000	(75,000)	(75,000)	(75,000)	(75,000)	(75,000)
Cash from financing activities	(155,577)	193,676	(1,755,431)	(1,112,110)	(1,069,501)	(1,054,023)	(953,359)	(892,749)
Net change in cash during period	(539,746)	1,647,750	1,719,657	(268,969)	722,390	1,447,827	2,028,325	2,561,119

HISTORICAL STOCK PRICE



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