

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 1996.

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission file number 0-27824

PIA MERCHANDISING SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

33-0684451
(I.R.S. Employer
Identification No.)

1990 MacArthur Blvd., Suite 900, Irvine, CA 92612
(Address of principal executive offices)

(714) 476-2200
(Registrant's telephone number, including area code)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

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 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: Yes No

Applicable only to corporate issuers:

Indicate the number of shares outstanding of each of the issuer's classes of stock, as of the latest practicable date.

Common Stock, \$.01 Par Value: 5,815,206 shares as of October 31, 1996.

PIA Merchandising Services, Inc.

PART I: FINANCIAL INFORMATION

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and December 31, 1995

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September 30, 1995 (Unaudited)

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SIGNATURES

PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	September 30, 1996 ----- (Unaudited)	December 31, 1995 -----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$17,865	\$ 185
Accounts receivable, net of allowance for doubtful accounts	20,682	12,213
Prepaid expenses and other current assets	860	638
Deferred income taxes	493	493
	-----	-----
Total current assets	39,900	13,529
PROPERTY AND EQUIPMENT, net	1,950	2,110
OTHER ASSETS	914	447
	-----	-----
	\$42,764	\$16,086
	-----	-----
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 743	\$ 1,838
Other current liabilities	6,478	4,105
Income taxes payable	228	455
	-----	-----
Total current liabilities	7,449	6,398
DEFERRED INCOME TAXES	300	300
LONG-TERM DEBT	0	3,400
STOCKHOLDERS' EQUITY	35,015	5,988
	-----	-----
	\$42,764	\$16,086
	-----	-----
	-----	-----

See accompanying notes.

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	For the Three Months Ended September 30,	
	1996	1995
	----	----
NET REVENUES	\$33,589	\$28,177
OPERATING EXPENSES:		
Field service costs	26,483	22,098
Selling expenses	2,885	2,731
General and administrative expenses	2,140	1,653
Depreciation and amortization	154	128
	-----	-----
Total operating expenses	31,662	26,610
	-----	-----
OPERATING INCOME	1,927	1,567
INTEREST INCOME (EXPENSE), NET	261	(99)
	-----	-----
INCOME BEFORE PROVISION FOR INCOME TAXES	2,188	1,468
PROVISION FOR INCOME TAXES	851	515
	-----	-----
NET INCOME	\$ 1,337	\$ 953
	-----	-----
NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE	\$ 0.21	\$ 0.22
	-----	-----
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES	6,251	4,309
	-----	-----

See accompanying notes.

PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	For the Nine Months Ended September 30,	
	1996	1995
	----	----
NET REVENUES	\$86,703	\$78,517
OPERATING EXPENSES:		
Field service costs	68,591	61,458
Selling expenses	8,508	7,711
General and administrative expenses	5,733	4,944

Depreciation and amortization	453	361
	-----	-----
Total operating expenses	83,285	74,474
	-----	-----
OPERATING INCOME	3,418	4,043
INTEREST INCOME (EXPENSE), NET	590	(358)
	-----	-----
INCOME BEFORE PROVISION FOR INCOME TAXES	4,008	3,685
PROVISION FOR INCOME TAXES	1,568	1,293
	-----	-----
NET INCOME	\$ 2,440	\$ 2,392
	-----	-----
NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE	\$ 0.41	\$ 0.56
	-----	-----
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES	5,972	4,309
	-----	-----

See accompanying notes.

PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)
(UNAUDITED)

For the Nine Months Ended September 30,

	1996	1995
	----	----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,440	\$ 2,392
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	453	361
Amortization of other assets and discount on subordinated debt	11	67
Provision for doubtful receivables	282	147
Deferred income taxes, net	0	46
Changes in operating assets and liabilities	(8,401)	(2,904)
	-----	-----
Net cash (used in) provided by operating activities	(5,215)	109
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(293)	(527)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of long term debt	(3,400)	(651)
Repurchase of common stock	0	(24)
Proceeds from issuance of common stock, net	26,588	0
	-----	-----
Net cash provided by (used in) financing activities	23,188	(675)
	-----	-----
NET INCREASE (DECREASE) IN CASH		

AND CASH EQUIVALENTS	17,680	(1,093)
CASH AND CASH EQUIVALENTS, beginning of period	185	1,414
	-----	-----
CASH AND CASH EQUIVALENTS, end of period	\$17,865	\$ 321
	-----	-----
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	\$ 0	\$ 322
Cash paid for income taxes	\$ 1,820	\$1,119

See accompanying notes.

PIA Merchandising Services, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The Three and Nine Months Ended September 30, 1996

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. This financial information should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 1995, included in the Company's Registration Statement on Form S-1, which was declared effective on February 29, 1996. Operating results for the three and nine month periods ended September 30, 1996 are not necessarily indicative of the results that may be expected for the year ended December 31, 1996.

2. Net Income per Share

Net income per share is based on the weighted average number of outstanding shares of common stock and dilutive common equivalent shares from stock options and warrants (using the treasury stock method).

3. Initial Public Offering

In March 1996, the Company completed its initial public offering of 2,137,800 shares of unissued common stock and 544,000 shares of outstanding common stock that were offered by certain selling stockholders. The Company received net proceeds of approximately \$26.6 million after deducting expenses and underwriting discounts. Concurrent with the offering, the Company was reincorporated in Delaware which resulted in an increase in authorized preferred stock to 3,000,000 shares, an increase in authorized common stock to 15,000,000 shares and a change in the par value of both the Company's common stock and preferred stock from no par value to \$.01 par value. This change in par value resulted in a reclassification of \$6,418,000 from common stock to additional paid-in capital.

4. Line of credit and long-term obligations

In March 1996, \$3.0 million of net proceeds from the initial public offering were used for repayment of bank line of credit indebtedness.

Results of Operations

Overview

PIA Merchandising Services, Inc. (the Company or PIA) provides merchandising services to manufacturers and retailers principally in grocery, mass merchandiser and chain and deep discount drug stores. For the quarters ended September 30, 1996 and 1995, the Company generated approximately 87.8% and 79.7% of its net revenues from manufacturer clients and 12.2% and 20.3% from retailer clients, respectively. For the nine month periods ended September 30, 1996 and 1995, the Company generated approximately 86.8% and 79.7% of its net revenues from manufacturer clients and 13.2% and 20.3% from retailer clients, respectively. The mix of the Company's business between manufacturer and retailer clients historically has not had a material impact on the Company's cash flows or results of operations.

PIA's quarterly results of operations are subject to certain variability related to the timing of retailer-mandated activity and the receipt of commission overrides. Retailer-mandated activity is typically higher in the second and third quarters of the year due to retailer scheduling of activity in off-peak shopping periods. In addition, new product introductions increase during such periods which require the reset of categories as the new products gain distribution. The amount of commissions earned by PIA under its commission-based contracts varies seasonally, and generally corresponds to the peak selling seasons of the clients that have entered into these types of contracts. Historically, the Company has recognized greater commission income in the first and fourth quarters. See "Risk Factors -- Uncertainty of Commission Income." The Company's quarterly results have in the past been subject to fluctuations and, thus, the operating results for any quarter are not necessarily indicative of results for any future period.

Results of Operations - Third Quarter of Fiscal 1996 Compared to Third Quarter of Fiscal 1995:

The following table sets forth certain financial data as a percentage of net revenues for the periods indicated:

	Three Months Ended September 30,	
	1996	1995
	----	----
Net revenues	100%	100%
Operating expenses:		
Field service costs	78.8%	78.4%
Selling expenses	8.6%	9.6%
General and administrative expenses	6.4%	5.9%
Depreciation and amortization	0.5%	0.5%
	-----	-----
Total operating expenses	94.3%	94.4%
	-----	-----
Operating income	5.7%	5.6%
Interest (income) expense, net	(0.8%)	0.4%
	-----	-----
Income before provision for income taxes	6.5%	5.2%
Provision for income taxes	2.5%	1.8%
	-----	-----
Net income	4.0%	3.4%
	-----	-----

Net revenue increased \$5.4 million, or 19.2%, to \$33.6 million in the third quarter of 1996 from \$28.2 million for the third quarter of 1995. The increase in net revenue for the third quarter includes \$5.7 million in revenue from services performed for new clients. A decline in revenues from ongoing routed coverage of \$.6 million was partially offset by increases in project revenue of \$.3 million during the quarter.

Field service costs increased \$4.4 million, or 19.8%, to \$26.5 million in the third quarter of 1996 compared to \$22.1 million in the third quarter of 1995. Field service costs are comprised principally of field labor and related costs and expenses required to provide routed coverage, project activities, key account management and related technology costs, as well as the field overhead required to support the activities of these groups of employees. The increase in field service costs was in line with the increase in net revenues. As a percentage of net revenues, field service costs were 78.8% in the third quarter of 1996 compared to 78.4% in the third quarter of 1995.

Selling expenses of \$2.9 million were approximately the same as last year. As a percentage of net revenues, selling expenses decreased to 8.6% in the third quarter of 1996 from 9.6% in the third quarter of 1995.

General and administrative expenses increased \$0.5 million, or 29.5%, to \$2.1 million in the third quarter of 1996 from \$1.6 million in the third quarter of 1995. General and administrative expenses increased primarily as a result of higher payroll costs due to increased staffing in general management and management information services that were required to support overall business growth, and salary increases in the ordinary course of business. As a percentage of net revenues, general and administrative expenses amounted to 6.4% in the third quarter of 1996 compared to 5.9% in the third quarter of 1995.

Depreciation and amortization expenses remained approximately the same for the third quarter of 1996 and 1995.

Interest income was \$0.3 million during the third quarter of 1996. The interest income resulted from the investment of a portion of the Company's initial public offering proceeds in interest bearing securities. These investments produced interest earnings throughout the third quarter of 1996. The Company had no interest expense during the third quarter of 1996.

Income taxes were \$0.9 million in the third quarter of 1996 and approximately \$0.5 million in the third quarter of 1995, representing an effective rate of 38.9% and 35.1%, respectively. The 1996 and 1995 tax rates differed from an expected combined federal and state tax rate of 40% due principally to interest earned in 1996 from tax exempt securities and to a \$0.1 million reduction in the valuation allowance caused by the utilization of net operating loss carryforwards in 1995.

Net income increased approximately \$0.4 million, or 40.3%, to approximately \$1.3 million in the third quarter of 1996, from approximately \$1.0 million in the third quarter of 1995, primarily as a result of increased revenues, the reduction in operating expenses as a percent of sales and interest income from investment of the proceeds of the initial public offering.

Results of Operations - Nine Months Ended September 30, 1996 Compared to Nine Months Ended September 30, 1995:

The following table sets forth certain financial data as a percentage of net revenues for the periods indicated:

	Nine Months Ended September 30,	
	1996	1995
	----	----
Net revenues	100%	100%
Operating expenses:		
Field service costs	79.2%	78.3%
Selling expenses	9.8%	9.8%
General and administrative expenses	6.6%	6.3%
Depreciation and amortization	0.5%	0.5%
	-----	-----
Total operating expenses	96.1%	94.9%
	-----	-----
Operating income	3.9%	5.1%
Interest (income) expense, net	(0.7%)	0.5%

	-----	-----
Income before provision for income taxes	4.6%	4.6%
Provision for income taxes	1.8%	1.6%
	-----	-----
Net income	2.8%	3.0%
	-----	-----

Net revenue increased \$8.2 million, or 10.4%, to \$86.7 million in the first nine months of 1996 from \$78.5 million for the corresponding period of 1995. The increase in net revenue includes \$6.4 million in revenue from services performed for new clients. Revenues for the nine months ended September 30, 1996 from ongoing routed coverage increased \$.3 million and project revenue increased \$1.5 million from the corresponding period in 1995.

Field service costs increased \$7.1 million, or 11.6%, to \$68.6 million in the first nine months of 1996 compared to \$61.5 million for the corresponding period of 1995. The increase in field service costs was the result of increased operating costs associated with revenue growth and a reduction of margins due to a strategic decision by the Company to maintain employment levels in field service and field management personnel in anticipation of new business in the second quarter. As a percentage of net revenues, field service costs increased to 79.2% in the first nine months of 1996 from 78.3% for the corresponding period of 1995.

Selling expenses increased \$0.8 million or 10.3%, to \$8.5 million in the first nine months of 1996 from \$7.7 million for the corresponding period of 1995. As a percentage of net revenues, selling expenses were 9.8% in both the first nine months of 1996 and 1995.

General and administrative expenses increased \$0.8 million, or 16.0%, to \$5.7 million in the first nine months of 1996 from \$4.9 million for the corresponding period of 1995. General and administrative expenses increased primarily as a result of higher payroll costs due to increased staffing in general management and management information services that were required to support overall business growth, salary increases in the ordinary course of business, and legal expenses associated with the negotiation of a significant new contract. As a percentage of net revenues, general and administrative expenses increased to 6.6% in the first nine months of 1996 from 6.3% for the corresponding period of 1995. The increase was principally the result of the increased spending noted above and lower than anticipated net revenues.

Depreciation and amortization expenses remained approximately the same for the first nine months of 1996 and 1995.

Net interest income was \$0.6 million during the first nine months of 1996. Interest expense in the corresponding period of 1995 was \$0.4 million. The interest income resulted from the investment of a portion of the Company's initial public offering proceeds in interest bearing securities.

Income taxes were \$1.6 million for the first nine months of 1996 and approximately \$1.3 million in the corresponding period of 1995, representing an effective rate of 39.1% and 35.1%, respectively. The 1996 and 1995 tax rates differed from an expected combined federal and state tax rate of 40% due principally to interest earned from tax exempt securities in 1996 and to a \$0.2 million reduction in the valuation allowance caused by the utilization of net operating loss carryforwards in 1995.

Net income remained approximately the same for the first nine months of 1996 and 1995. Increases in revenues were offset by higher field service costs and other expenses.

RISK FACTORS

The following risk factors should be carefully reviewed in addition to the other information contained in this Quarterly Report on Form 10-Q.

Concentrated Client Base

The Company's success is dependent in part upon its ability to maintain its existing clients and to obtain new clients. The Company's ten largest clients generated approximately 61.3% and 59.8% of the Company's net revenue for the quarters ended September 30, 1996 and 1995, respectively, and 58.1% and 59.8% of net revenue for the nine month periods ended September 30, 1996 and 1995, respectively. During these periods, none of the Company's manufacturer or retailer clients accounted for greater than 10% of net revenues, other than (i) Buena Vista Home Video which accounted for approximately 16.9% for the quarter ended September 30, 1996; (ii) S.C. Johnson Wax, which accounted for approximately 11.5% of net revenues for the nine month period ended September 30, 1996, and 10.6% for the quarter ended September 30, 1995; and (iii) Thrifty Payless, Inc. which accounted for approximately 15.0% and 14.4% for the quarter and for the nine month period ended September 30, 1995, respectively. The Company's contracts with its clients range from one to five years. PIA believes that the uncollectibility of amounts due from any of its large clients, the loss of one or more of such clients, a significant reduction in business from such clients, or the inability to attract new clients, could have a material adverse effect on the Company's results of operations.

Increase in Services Required Under Fixed Price Contracts

Manufacturers who sell their products through retail grocery stores generally are required by the retailer to provide labor support inside these stores for a variety of purposes, including new store sets and existing store resets, remerchandisings, remodels and category implementations. The Company has historically contracted with its manufacturer clients to provide these services, among others, for a monthly flat fee or, in some cases, for a commission. Substantially all of the Company's current contracts provide for one of these two types of arrangements. As requests for retailer-mandated services and new product introductions by manufacturers have increased over the past several years, the Company's labor expense has increased without any related increase in its revenue. Consequently, the Company has reevaluated its approach to contracting with its clients, and is currently engaged in an effort to revise its existing contracts upon their renewal to implement provisions that charge for retailer-mandated services separately from traditional merchandising and shelf maintenance tasks. In addition, the Company has recently developed a new, standard contract that provides this activity-based approach to pricing for the Company's more recent customers. The Company has recently renewed its contracts with two of its major manufacturer clients using activity-based pricing, and is currently in the process of renegotiating contracts upon their annual renewal with certain of its other major clients. However, no assurance can be given that PIA will be successful in renewing its other contracts on this basis. If PIA is not successful in so renegotiating its major contracts, its margins could be adversely affected.

Uncertainty of Commission Income

Approximately 15.3% and 18.4% of the Company's net revenues for the quarter and nine month period ended September 30, 1996, respectively, was earned under commission-based contracts. These contracts provide for commissions based on a percentage of the client's net sales of certain of its products to designated retailers. Some of these contracts also provide for a guaranteed minimum compensation to the Company. Commissions paid to PIA under these contracts have had a significant effect on the Company's profitability in certain quarters.

Under these contracts, the Company generally receives a draw on a monthly or quarterly basis, which is then applied against commissions earned. Adjustments are made on a monthly or quarterly basis upon receipt of reconciliations between commissions earned from the client and the draws previously received. The reconciliations typically result in commissions owed to the Company in excess of previous draws; however, the Company cannot predict with accuracy the level of its clients' commission-based sales. Accordingly, the amount of commissions in excess of or less than the draws previously received will fluctuate and can significantly affect the Company's operating results in any quarter.

In addition, the amount of commissions earned by the Company under these contracts varies seasonally, and generally corresponds to the peak selling seasons of the clients who have entered into these types of contracts.

Historically, the Company has recognized greater commission income in its first and fourth quarters due to the timing of such clients' sales.

PIA Merchandising Services, Inc.

PART II: OTHER INFORMATION

Item 1: Legal Proceedings
None

Item 2: Changes in Securities
None

Item 3: Defaults Upon Senior Securities
None

Item 4: Submission of Matters to a Vote of Security Holders
None

Item 5: Other Information
None

Item 6: Exhibits and Reports on Form 8-K.
(27) Financial Data Schedules

The Company did not file any reports on Form 8-K during the three months ended September 30, 1996.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PIA MERCHANDISING SERVICES, INC.
(Registrant)

By: /s/ Clinton E. Owens

Clinton E. Owens
Chairman of the Board and
Chief Executive Officer

By: /s/ Roy L. Olofson

Roy L. Olofson
Executive Vice President and
Chief Financial Officer

Dated: November 14, 1996

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