PSYCHEMEDICS CORP
Form 10-Q
August 13, 2009

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2009
or

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 number: 1-13738
PSYCHEMEDICS CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware	**58-1701987**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
125 Nagog Park Acton, MA	**01720**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number including area code: (978) 206-8220

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer o	Accelerated filer o	Non-accelerated filer (Do not check if smaller reporting Company)	Smaller Reporting Company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No þ

The number of shares of Common Stock of the Registrant, par value $0.005 per share, outstanding at August 6, 2009 was 5,197,031.

PSYCHEMEDICS CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2009
INDEX

Exhibit 32.2

Table of Contents

PSYCHEMEDICS CORPORATION
CONDENSED BALANCE SHEETS
(UNAUDITED)

	June 30, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,954,122	$ 6,630,119
Accounts receivable, net of allowance for doubtful accounts of $173,116 in 2009 and $246,462 in 2008	2,828,941	3,398,455
Prepaid expenses	851,753	1,023,841
Other current assets	262,079	82,045
Deferred tax assets	531,083	449,398
Total Current Assets	9,427,978	11,583,858
Fixed Assets		
Equipment & leasehold improvements	10,907,974	10,877,479
Less accumulated depreciation	(10,230,991)	(10,047,755)
Net Fixed Assets	676,983	829,724
Deferred tax assets, long term	139,021	139,021
Other assets	84,567	75,183
Total Assets	$ 10,328,549	$ 12,627,786
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Current Liabilities:		
Accounts payable	$ 353,237	$ 644,894
Accrued expenses	821,193	1,268,924
Deferred revenue	58,905	154,080
Total Current Liabilities	1,233,335	2,067,898
Commitments and Contingencies		
Shareholders Equity		
Preferred-stock, $0.005 par value, 872,521 shares authorized, no shares issued or outstanding		
	29,308	29,216

Common stock, $0.005 par value; 50,000,000 shares authorized 5,861,554 shares issued in 2009 and 5,843,068 shares issued in 2008		
Paid-in capital	27,287,255	27,118,743
Accumulated deficit	(8,167,985)	(6,614,114)
Less Treasury stock, at cost, 664,523 shares in 2009 and 647,304 shares in 2008	(10,053,364)	(9,973,957)
Total Shareholders Equity	9,095,214	10,559,888
Total Liabilities and Shareholders Equity	$ 10,328,549	$ 12,627,786

See accompanying notes to financial statements and management s discussion and analysis of financial condition and results of operations.

Table of Contents

PSYCHEMEDICS CORPORATION
CONDENSED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenue	$ 3,934,923	$ 6,211,077	$ 8,013,760	$ 11,919,941
Cost of Revenue	1,829,097	2,434,913	3,816,008	4,822,215
Gross Profit	2,105,826	3,776,164	4,197,752	7,097,726
General & Administrative expense	879,367	1,095,015	1,921,861	2,117,318
Marketing & Selling expense	810,934	902,726	1,682,399	1,701,371
Research & Development expense	117,517	119,714	242,563	237,494
Total Operating Expenses	1,807,818	2,117,455	3,846,823	4,056,183
Operating Income	298,008	1,658,709	350,929	3,041,543
Interest Income	7,083	73,191	22,589	184,962
Net Income Before Provision for Income Taxes	305,091	1,731,900	373,518	3,226,505
Provision for Income Taxes	130,710	699,000	160,613	1,304,000
Net Income	$ 174,381	$ 1,032,900	$ 212,905	$ 1,922,505
Basic net income per share	$ 0.03	$ 0.20	$ 0.04	$ 0.37
Diluted net income per share	$ 0.03	$ 0.20	$ 0.04	$ 0.36
Dividends declared per share	$ 0.12	$ 0.17	$ 0.29	$ 0.32
Weighted average common shares outstanding, basic	5,178,545	5,224,328	5,184,612	5,222,098
	5,190,632	5,286,408	5,197,487	5,280,577

Weighted average common shares outstanding,
diluted

See accompanying notes to financial statements and management s discussion and analysis of financial condition and results of operations.

Table of Contents

PSYCHEMEDICS CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash Flows From Operating Activities		
Net income	$ 212,905	$ 1,922,506
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	184,806	166,125
Stock-based compensation	207,242	166,050
Deferred income tax	(81,685)	(61,783)
Changes in assets and liabilities:		
Accounts receivable	569,514	(320,268)
Prepaid expenses and other current assets	(7,946)	(455,858)
Accounts payable	(291,657)	94,072
Accrued expenses	(486,369)	30,128
Accrued income tax		(16,925)
Deferred revenue	(95,175)	(49,635)
Net Cash Provided By Operating Activities	**211,635**	**1,474,412**
Cash Flows (Used In) Provided by Investing Activities		
Purchases of short-term investments		1,475,000
Purchases of equipment and leasehold improvements	(30,495)	(46,013)
Other assets	(10,954)	(18,263)
Net Cash (Used In) Provided By Investing Activities:	**(41,449)**	**1,410,724**
Cash Flows Used In Financing Activities		
Net proceeds from issuance of common stock		191,460
Acquisition of treasury stock	(79,407)	(381,775)
Cash dividends paid	(1,766,776)	(1,673,807)
Net Cash Used In Financing Activities:	**(1,846,183)**	**(1,864,122)**
Net (Decrease) Increase In Cash:	**(1,675,997)**	**1,021,014**
Cash and Cash Equivalents, Beginning Of Period:	6,630,119	6,096,664

Cash and Cash Equivalents, End Of Period:	$ 4,954,122	$ 7,117,678
Supplemental Disclosures of Cash Flow Information		
Cash paid for income taxes		$ 1,468,021

See accompanying notes to financial statements and management s discussion and analysis of financial condition and results of operations.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

1. Interim Financial Statements

The accompanying unaudited interim financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. Accordingly, certain information and footnote disclosure required for complete financial statements are not included herein. It is recommended that these financial statements be read in conjunction with the financial statements and related notes of Psychemedics Corporation (the Company, our Company, our or we) as reported in the Company s Annual Report on Form 10-K for the year ended December 31 2008, filed on March 23, 2009. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of financial position, results of operations, and cash flows at the dates and for the periods presented have been included. The results of operations for the three and six months ended June 30, 2009 may not be indicative of the results that may be expected for the year ending December 31, 2009, or any other period.

2. Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of 90 days or less to be cash equivalents. Cash equivalents consist of cash savings and U.S. government reserve money market accounts at June 30, 2009 and 2008. While the money market account contains U.S. federal government backed issues, the account itself is not federally insured. As of June 30, 2009, $4.0 million was in U.S. federal government-backed money market accounts.

3. Stock-Based Compensation

The Company s 2006 Equity Incentive Plan provides for the grant or issuance to officers, directors, employees and consultants of options with terms of up to ten years, restricted stock, issuances of stock bonuses or other stock-based awards, covering up to 250,000 shares of common stock. As of June 30, 2009, 158,100 shares remained available for future grant under the 2006 Equity Incentive Plan.

The Company did not grant any stock unit awards (SUAs) in the first or second quarter of 2009. The Company did grant 32,600, 1,000 and 800 SUAs to certain members of management and its directors on May 15, October 14, and November 3, 2008, respectively. Furthermore, 1,200 SUA s were terminated during the year. The fair value of the SUAs was determined by the closing price on the date of grant. The SUAs vest over a period of two to four years and are convertible into an equivalent number of shares of the Company s common stock provided that the employee receiving the award remains continuously employed throughout the vesting period. The Company records compensation expense related to the SUAs on a straight-line basis over the vesting term of the SUA. Employees are issued shares upon vesting, net of tax withholdings.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

3**. Stock-Based Compensation (continued)**

A summary of activity for SUAs (Stock Unit Awards) under the Company s 2006 Equity Incentive Plan for the six months ended June 30, 2009 is as follows:

	Number of Shares	Aggregate Intrinsic Value (1) (000s)
Unvested, December 31, 2008	67,600	
Granted		
Forfeited/expired	(6,064)	
Converted to common stock	(18,486)	
Unvested, June 30, 2009	43,050	$ 296
Available for grant, June 30, 2009	158,100	

(1) The aggregate intrinsic value on this table was calculated based on the closing market value of the Company s stock on June 30, 2009 ($6.88).

A summary of stock option activity for the Company s expired stock option plans for the six months ended June 30, 2009 is as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (2) (000s)
Outstanding, December 31, 2008	392,110	$ 15.22		
Granted				
Exercised				
Terminated/Expired	43,751	$ 17.87		
Outstanding, June 30, 2009	348,359	$ 14.88	4.4 years	$
Exercisable, June 30, 2009	348,359	$ 14.88	4.4 years	$

Available for grant, June 30, 2009

(2) The aggregate intrinsic value on this table was calculated based on the amount, if any, by which the closing market value of the Company s stock on the June 30, 2009 ($6.88) exceeded the exercise price of the underlying options, multiplied by the number of shares subject to each option.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

3. Stock-Based Compensation (continued)

As of June 30, 2009, a total of 549,509 shares of common stock were reserved for issuance under the various stock option and stock-based plans. As of June 30, 2009, the unamortized fair value of awards relating to SUAs was $675 thousand.

4. Basic and Diluted Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common equivalent shares outstanding during the period. The number of dilutive common equivalent shares outstanding during the period has been determined in accordance with the treasury-stock method. Common equivalent shares consist of common stock issuable upon the exercise of outstanding options and assume the full vesting of all outstanding, unvested SUAs. The Company s unvested SUAs do not have stock dividend rights and, consequently, are not included in share totals.

Basic and diluted weighted average common shares outstanding are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2009	**June 30, 2008**	**June 30, 2009**	**June 30, 2008**
	(in thousands)			
Weighted average common shares	5,179	5,224	5,185	5,222
Common equivalent shares	12	62	12	59
Weighted average common shares outstanding, assuming dilution	5,191	5,286	5,197	5,281

For the three and six months ended June 30, 2009 and 2008, options to purchase 364 thousand and 142 thousand common shares, respectively, were outstanding but not included in the diluted weighted average common share calculation as the effect would have been antidilutive.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

5. Revenue Recognition

The Company is in the business of performing drug testing services and reporting the results thereof. The Company s drug testing services include training for collection of samples and storage of positive samples for its customers for an agreed-upon fee per unit tested of samples. The revenues are recognized when the predominant deliverable, drug testing, is provided and reported to the customer.

The Company recognizes revenue under Emerging Issue Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. In accordance with EITF 00-21, the Company considers testing, training and storage elements as one unit of accounting for revenue recognition purposes, as the training and storage costs are de minimis and do not have stand-alone value to the customer. The Company recognizes revenue as the service is performed and reported to the customer, since the predominant deliverable in each arrangement is the testing of the units.

The Company also provides expert testimony, when and if necessary, to support the results of the tests, which is generally billed separately and recognized as the services are provided.

Deferred revenue represents payments received in advance of the performance of drug testing procedures, generally in relation to the personal drug testing kits PDT-90. Deferred revenue is recognized as revenue when the underlying test results are delivered. With respect to a portion of these transactions, there may be instances where the customer ultimately does not require performance. Revenue is then recognized when the Company can reasonably, reliably and objectively determine that it is remote that performance will be required for an estimable portion of transactions. The Company recorded $67 thousand and $21 thousand of revenue in the results of operations for the three months ended June 30, 2009 and 2008, respectively, related to test kits that were sold for which the Company s obligations to provide service were deemed remote. The Company recorded $102 thousand and $50 thousand of revenue in the results of operations for the six months ended June 30, 2009 and 2008, respectively, related to test kits that were sold for which the Company s obligations to provide service were deemed remote.

At June 30, 2009 and December 31, 2008, the Company had deferred revenue of approximately $59 thousand and $154 thousand, respectively, reflecting sales of its personal drug testing service for which the performance of the related test had not yet occurred and future obligations were not deemed remote.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
UNAUDITED

6. Fair Value Measurements

SFAS No. 157, *Fair Value Measurements* (SFAS 157) provides guidance for using fair value to measure assets and liabilities. It also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy prioritizes the inputs in three broad levels as follows:

Level 1 inputs are unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.

Level 2 inputs are quoted prices for similar assets and liabilities in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 inputs are prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial asset s or liability s classification within the hierarchy is determined based on the lowest level of any input that is significant to the fair value measurement.

The financial assets of the Company measured at fair value on a recurring basis are cash and cash equivalents. The Company s cash and cash equivalents are classified within level 1 of the fair value hierarchy because they are valued using quoted market prices that are accessible at the measurement date for identical assets and liabilities.

Table of Contents

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
UNAUDITED

6. Fair Value Measurements (continued)

In February 2008, the FASB issued Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2) that defers the effective date of applying the provisions of SFAS 157 to the fair value measurement of nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (or at least annually), until fiscal years beginning after November 15, 2008. The Company believes that FSP 157-2 does not have a material impact on its results of operations and financial condition.

7. Recent Accounting Pronouncements

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP No. 142-3). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The objective of FSP No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(revised 2007), *Business Combinations,* (SFAS 141(R)), and other accounting principles generally accepted in the United States. FSP No. 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise, and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. The Company is in the process of evaluating FSP No. 142-3 and does not expect it to have a significant impact on its financial statements.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will become effective as of the beginning of the Company s fiscal year beginning after December 15, 2008. SFAS 141R will be adopted on a prospective basis for new acquisitions subsequent to the effective date. With respect to potential transactions that may be executed subsequent to adoption, the accounting consequences could be materially different than under the current accounting rules.

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1). This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, *Accounting for Contingencies* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* . Further, the FASB removed the subsequent accounting guidance for assets and liabilities arising from contingencies from SFAS No. 141(R). The requirements of FSP FAS 141(R)-1 carry forward without significant revision of the guidance on contingencies of SFAS No. 141, *Business Combinations* , which was superseded by SFAS No. 141(R) (see previous paragraph). FSP FAS 141(R)-1 also eliminates the requirement to disclose an estimate of the range of possible outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, the FASB requires that entities include only the disclosures required by SFAS No. 5. FSP FAS 141(R)-1 will become effective as of the beginning of the Company s fiscal year beginning after December 15, 2008. With respect to potential transactions that may be executed subsequent to adoption, the accounting consequences could be materially different than under the current accounting rules.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 extends the disclosure requirements of SFAS No. 107, Disclosures About Fair Value of Financial Instruments (SFAS 107), to interim period financial statements, in addition to the existing requirements for annual periods and reiterates SFAS 107 s requirement to disclose the methods and significant assumptions used to estimate fair value. FSP FAS 107-1 and APB 28-1 was effective for the Company s interim and annual periods commencing with its June 30, 2009 consolidated financial statements and have been applied on a prospective basis. FSP FAS 107-1 and APB 28-1 did not have a material impact on the Company s consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 sets forth: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. The Company adopted SFAS 165 in the quarter ended June 30, 2009. SFAS 165 did not impact the consolidated financial statements for this period. The Company evaluated all events or transactions that occurred after June 30, 2009 up through August 14, 2009, the date the Company issued these financial statements. During this period, the Company did not have any material recognizable subsequent events.

Table of Contents

8. Commitments and Contingencies

The Company is subject to legal proceedings and claims, which arise in the ordinary course of its business. The Company believes that based upon information available to the Company at this time, the expected outcome of these matters would not have a material impact on the Company s results of operations or financial condition.

9. Subsequent Event Dividends

On August 4, 2009, the Company declared a quarterly dividend of $0.12 per share for a total of $703 thousand, which will be paid on September 18, 2009 to shareholders of record on September 4, 2009.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FACTORS THAT MAY AFFECT FUTURE RESULTS

From time to time, information provided by the Company or statements made by its employees may contain forward-looking information which involves risks and uncertainties. In particular, statements contained in this report which are not historical facts (including, but not limited to, the Company s expectations regarding earnings, earnings per share, revenues, operating cash flows, dividends, future business, growth opportunities, new accounts, customer base, test volume, sales and marketing strategy, business strategy, general and administrative expenses, marketing and selling expenses, research and development expenses, anticipated operating results, strategies with respect to governmental agencies and regulations, cost savings, capital expenditures, liquidity of investments and anticipated cash requirements) may be forward-looking statements. The Company s actual results may differ from those stated in any forward-looking statements. Factors that may cause such differences include, but are not limited to, risks associated with the expansion of the Company s sales and marketing team, employee hiring practices of the Company s principal customers, development of markets for new products and services offered by the Company, the economic health of principal customers of the Company, global credit market volatility, financial and operational risks associated with possible expansion of testing facilities used by the Company, government regulation (including, but not limited to, Food and Drug Administration regulations), competition and general economic conditions. With respect to the continued payment of cash dividends, factors include, but are not limited to, available surplus, cash flow, capital expenditure reserves required, and other factors that the Board of Directors of the Company may take into account.

Table of Contents

OVERVIEW

Psychemedics Corporation was incorporated in 1986. The Company is the world s largest provider of hair testing for drugs of abuse, utilizing a patented hair analysis method involving radioimmunoassay technology and confirmation by mass spectrometry to analyze human hair to detect abused substances. The Company s customers include Fortune 500 companies, as well as small to mid-size corporations, schools and governmental entities located primarily in the United States.

Revenue for the second quarter of 2009 was $3.9 million, a decrease of 37% from second quarter 2008 revenue of $6.2 million. A drop in testing volume was the reason for the decrease in revenue. The Company reported net income of $0.03 and $0.20 per diluted share for the three months ended June 30, 2009 and 2008, respectively. At June 30, 2009, the Company had $5.0 million of cash and cash equivalents. The Company distributed $883 thousand or $0.17 per share of cash dividends to its shareholders in the three months ended June 30, 2009. The Company has paid fifty-one consecutive quarterly cash dividends.

RESULTS OF OPERATIONS

Revenue was $3.9 million for three months ended June 30, 2009 compared to revenue of $6.2 million for the three months ended June 30, 2008, representing a decrease of 37%. The decrease in revenue for the three months ended June 30, 2009 was a result of a decrease in testing volume from new and existing clients of 38%, while the average revenue per sample increased 2% during the same period. Revenue for the six months ended June 30, 2009 was $8.0 million, representing a decrease of 33% in revenue from the comparable period of 2008 of $11.9 million. The reason was a decrease in volume, as test samples were down 34% from the first half of 2008.

Gross profit decreased $1.7 million to $2.1 million for the three months ended June 30, 2009, compared to $3.8 million for the three months ended June 30, 2008. Direct costs fell by $600 thousand or 25% for the three months ended June 30, 2009 compared to the same period in 2008, mainly due to decreased labor and labor-related costs. The gross profit margin decreased to 54% for the three months ended June 30, 2009 compared to 61% for the comparable period of 2008. Gross profit for the six months ended June 30, 2009 decreased $2.9 million to $4.2 million compared to $7.1 million for the comparable period in 2008. Direct costs decreased by over $1 million or 21% for the six months ended June 30, 2009 when compared to the same period in 2008, mainly due to decreased labor and associated costs. The gross profit margin fell to 52% for the six month period ended June 30, 2009 from 60% during the same period in 2008 due to the fact that labor costs were adjusted late in the quarter and their full financial impact did not take effect.

General and administrative (G&A) expenses were $0.9 million for the three months ended June 30, 2009 and $1.1 million for the same period in 2008. As a percentage of revenue, G&A expenses were 22% and 18% for the three months ended June 30, 2009 and 2008, respectively. General and administrative expenses were $1.9 million for the six months ended June 30, 2009 compared to $2.1 million for the comparable period in 2008, representing a 9% decrease. As a percentage of revenue, G&A expenses were 24% and 18% for the six months ended June 30, 2009 and 2008, respectively. The decrease in general and administrative expenses for the three and six month periods was primarily driven by a decrease in legal fees associated with a slowdown in activity on pending cases in 2009 compared to 2008.

Marketing and selling expenses were $811 thousand for the three months ended June 30, 2009 as compared to $903 thousand for the three months ended June 30, 2008, a decrease of 10%. Total marketing and selling expenses represented 21% and 15% of revenue for the three months ended June 30, 2009 and 2008, respectively. The decrease in marketing and selling expenses was due to lower staffing levels and related expenses. For the six months ended June 30, 2009 and 2008, marketing and selling expenses were $1.7 million, essentially flat from the prior year as lower revenue led to lower commissions. This was offset by greater number of marketing personnel than in 2008. Marketing and selling expenses represented 21% and 14% of revenue, respectively, as revenues have declined from 2008 levels.

Research and development (R&D) expenses for the three months ended June 30, 2009 were $118 thousand, compared to $120 thousand for the comparable period of 2008, a decrease of 2%. R&D expenses represented 3% and 2% of revenue in the second quarter 2009 and 2008, respectively. Research and development expenses for the six months ended June 30, 2009 were $243 thousand compared to $237 thousand. R&D expenses represented 3% and 2% of revenue respectively.

Interest income for the three months ended June 30, 2009 decreased by $66 thousand to $7 thousand when compared to the same period of 2008 in which interest income was $73 thousand. Interest income represented interest earned on cash and cash equivalents. Decreasing interest rates on our mix of cash and cash equivalents caused the decrease in interest income for the three month period ended June 30, 2009. Interest income for the six months ended June 30, 2009 decreased $162 thousand to $23 thousand as compared to $185 thousand for the same period in 2008. Interest income represented interest and dividends earned on cash and cash equivalents and investments. Decreasing interest rates on our mix of cash and cash equivalents caused the decrease in interest income for both the three and six month periods ended June 30, 2008.

Provision for income taxes During the three months ended June 30, 2009 and June 30, 2008, the Company recorded tax provisions of $131 thousand and $699 thousand respectively. During the six months ended June 30, 2009 and June 30, 2008, the Company recorded tax provisions of $161 thousand and $1.3 million respectively. These provisions represented effective tax rates of 43% and 40% for the periods ended June 30, 2009 and 2008, respectively.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2009, the Company had approximately $5.0 million of cash and cash equivalents. The Company s operating activities provided net cash of $250 thousand for the six months ended June 30, 2009. Investing activities used $41 thousand in the six month period while financing activities used $1.9 million during the period.

Cash provided by operating activities of $250 thousand reflected net income of $213 thousand adjusted for depreciation and amortization of $185 thousand, stock-based compensation of $207 thousand and an increase in accounts payable of $292 thousand and an increase in accrued expenses of $448 thousand. This was offset by a decrease in accounts receivable of $570 thousand and a change in deferred revenue of $95 thousand. Cash used in investing activities included a small amount of equipment and leasehold improvements which were purchased during the first half of 2009.

Table of Contents

During the six months ended June 30, 2009, the Company distributed $1.8 million in cash dividends to its shareholders. The Company repurchased 17,219 shares during the six months ended June 30, 2009 for $79 thousand. In March 2008, the Board of Directors of the Company also authorized, under a new repurchase program, 250,000 shares for repurchase. 17,219 shares have been repurchased since January 1, 2009. In total, 664,523 shares have been repurchased.

Contractual obligations as of June 30, 2009 were as follows:

	Less Than One Year	1-3 Years	4-5 years	After 5 Years	Total
			(in thousands)		
Operating leases	$ 520	$ 1,051	$ 120	$	$ 1,691
Purchase commitment	289				289
	$ 809	$ 1,051	$ 120	$	$ 1,980

The Company has a supply agreement with a vendor which requires the Company to purchase isotopes used in its drug testing procedures from this sole supplier in exchange for variable annual payments based upon prior year purchases. Purchases amounted to $290 thousand for the six months ended June 30, 2009 as compared to $304 thousand for the comparable period of 2008. The Company expects to purchase approximately $289 thousand for the remainder of 2009. In exchange for exclusivity, among other things, the supplier has provided the Company with the right to purchase the isotope technology at fair market value under certain conditions, including the failure to meet the Company s purchase commitments. This agreement does not include a fixed termination date; however, it is cancelable upon mutual agreement by the parties or six months after termination notice by the Company of its intent to use a different technology in connection with its drug testing procedures.

At June 30, 2009, the Company s principal sources of liquidity included an aggregate of approximately $5.0 million of cash and cash equivalents. Management currently believes that such funds, together with cash generated from operations, should be adequate to fund anticipated working capital requirements and capital expenditures in the near term. Depending upon the Company s results of operations and capital needs, the Company may use various financing sources to raise additional funds, although the Company does not have any such plans at this time. At June 30, 2009, the Company had no long-term debt.

Table of Contents

CRITICAL ACCOUNTING POLICIES

Management believes the most critical accounting policies are as follows:

Revenue Recognition

The Company is in the business of performing drug testing services and reporting the results thereof. The Company s drug testing services include training for collection of samples and storage of positive samples for its customers for an agreed-upon fee per unit tested of samples. The revenues are recognized when the predominant deliverable, drug testing, is provided and reported to the customer.

The Company recognizes revenue under Emerging Issue Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. In accordance with EITF 00-21, the Company considers testing, training and storage elements as one unit of accounting for revenue recognition purposes, as the training and storage costs are de minimis and do not have stand-alone value to the customer. The Company recognizes revenue as the service is performed and reported to the customer, since the predominant deliverable in each arrangement is the testing of the units.

The Company also provides expert testimony, when and if necessary, to support the results of the tests, which is generally billed separately and recognized as the services are provided.

Deferred revenue represents payments received in advance of the performance of drug testing procedures, generally in relation to the personal drug testing kits PDT-90. Deferred revenue is recognized as revenue when the underlying test results are delivered. With respect to a portion of these transactions, there may be instances where the customer ultimately does not require performance. Revenue is then recognized when the Company can reasonably, reliably and objectively determine that it is remote that performance will be required for an estimable portion of transactions. The Company recorded $67 thousand and $21 thousand of revenue in the results of operations for the three months ended June 30, 2009 and 2008, respectively, related to test kits that were sold for which the Company s obligations to provide service were deemed remote. The Company recorded $102 thousand and $50 thousand of revenue in the results of operations for the six months ended June 30, 2009 and 2008, respectively, related to test kits that were sold for which the Company s obligations to provide service were deemed remote

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates, including bad debts and income taxes, and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on management s assessment of the collectibility of its customer accounts. Management reviews its accounts receivable aging for doubtful accounts and specifically identifies accounts that may not be collectible. The Company routinely assesses the financial strength of its customers and, as a consequence, believes that its accounts receivable credit risk exposure is limited. The Company maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area. Bad debt expense has been within management s expectations.

Income Taxes

The Company accounts for income taxes using the liability method, which requires the Company to recognize a current tax liability or asset for current taxes payable or refundable and a deferred tax liability or asset for the estimated future tax effects of temporary differences between the financial statement and tax reporting bases of assets and liabilities to the extent that they are realizable. Deferred tax expense (benefit) results from the net change in deferred tax assets and liabilities during the year. A deferred tax valuation allowance is required if it is more likely than not that all or a portion of the recorded deferred tax assets will not be realized.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109*. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies) accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on an audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. The Company adopted the provisions of FIN 48, effective January 1, 2007, without material effect in the financial statements.

The Company operates within multiple taxing jurisdictions and could be subject to audit in these jurisdictions. These audits may involve complex issues, which may require an extended period of time to resolve. The Company has provided for its estimated taxes payable in the accompanying financial statements. Interest and penalties related to income tax matters are recognized as a general and administrative expense. The Company did not have any unrecognized tax benefits and did not have any interest or penalties accrued as of June 30, 2009 or December 31, 2008. The Company does not expect the unrecognized tax benefits to change significantly over the next twelve months.

Table of Contents

The above listing is not intended to be a comprehensive list of all of the Company s accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management s judgment in their application. There are also areas in which management s judgment in selecting any available alternative would not produce a materially different result.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity. The Company maintains cash and cash equivalents which consist of cash, money market funds and certificates of deposit with financial institutions. Due to the conservative nature and relatively short duration of our cash and cash equivalents, interest rate risk is mitigated.

Based on our ability to access our cash and cash equivalents, our expected operating cash flows and our other sources of cash, we do not anticipate that any lack of liquidity will materially affect our ability to operate our business.

Item 4. Controls and Procedures

As of the date of this report, our Chief Executive Officer and our Controller performed an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Controller concluded that the Company s disclosure controls and procedures are effective in ensuring the reporting of material information required to be included in the Company s periodic filings with the Securities and Exchange Commission. There were no significant changes in the Company s internal controls over financial reporting or in other factors that could significantly affect these internal controls over financial reporting subsequent to the date of the most recent evaluation.

Table of Contents

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2008 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no purchases of equity securities in the second quarter of 2009. On March 18, 2008, the Board of Directors authorized a new repurchase program. Under the 2008 program, the Company is authorized to repurchase up to 250,000 shares of the Company s common stock, subject to certain market conditions. As of June 30, 2009, there have been 47,077 shares repurchased under this program, leaving 202,923 available for future repurchases.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders of Psychemedics Corporation was held on May 21, 2009 for the purpose of electing a board of directors. Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934 and there was no solicitation in opposition to management s solicitations.

Description and tabulation by the Company s transfer agent of each matter voted upon at the Annual Meeting of Shareholders of Psychemedics Corporation held on May 21, 2009:

All of management s nominees for directors, as listed in the proxy statement, were elected with the following votes:

	Number of Shares	
Name	**For**	**Withheld**
Raymond C. Kubacki, Jr	4,513,816	406,410
Harry F. Connick	4,509,022	411,224
Walter S. Tomenson, Jr.	4,506,708	413,538
Fred J. Weinert	4,450,975	469,271

Item 6. Exhibits

See Exhibit Index included in this Report.

Table of Contents

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.

	Psychemedics Corporation
Date: August 13, 2009	By: /s/ Raymond C. Kubacki, Jr. Raymond C. Kubacki, Jr. Chairman and Chief Executive Officer (principal executive officer)
Date: August 13, 2009	By: /s/ Raymond J. Ruddy Raymond J. Ruddy Vice President of Finance and Controller (principal financial officer)

PSYCHEMEDICS CORPORATION
FORM 10-Q
June 30, 2009
EXHIBIT INDEX

		Page No.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
31.2	Certification of Principal Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
32.2	Certification of Principal Accounting Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	