Section 1: 10-Q (FORM 10-Q)

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

FORM 10-Q

[X] Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2019
or

[ ] 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.)**
289 Great Road Acton, MA	**01720**
(Address of Principal Executive Offices)	**(Zip Code)**

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

Securities registered pursuant to section 12(b) of the act:

Title of Class	Trading Symbol(s)	Name of each exchange on which registered
Common stock. $0.005 par value	**PMD**	**The Nasdaq Stock Market, LLC.**

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 X No____

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes X No____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐
Accelerated filer	☒
Non–accelerated filer	☐
Smaller reporting company	☒
Emerging growth company	☐

If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 ____ No X

The number of shares of Common Stock of the Registrant, par value $0.005 per share, outstanding at July 20, 2019 was 5,516,931.

PSYCHEMEDICS CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2019

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PSYCHEMEDICS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)
(UNAUDITED)

	June 30, 2019	December 31, 2018
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,097	$ 4,069
Marketable securities	—	3,905
Accounts receivable, net of allowance for doubtful accounts of $46 in 2019 and $67 in 2018	4,526	4,829
Prepaid expenses and other current assets	1,700	1,067
Total Current Assets	13,323	13,870
Fixed assets, net of accumulated amortization and depreciation of $14,820 in 2019 and $13,341 in 2018	9,503	10,177
Other assets	893	927
Operating lease right-of-use assets	1,416	—
Total Assets	$ 25,135	$ 24,974
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 704	$ 682
Accrued expenses	2,220	2,962
Current portion of long-term debt	416	416
Current portion of operating lease liabilities	861	—
Total Current Liabilities	4,201	4,060
Long-term debt	1,005	1,212
Deferred tax liabilities, long-term	897	955
Operating lease liabilities, long-term	555	—
Total Liabilities	6,658	6,227
Commitments and Contingencies (Note 7)		
Shareholders' Equity:		
Preferred stock, $0.005 par value, 873 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.005 par value; 50,000 shares authorized		
Shares issued and outstanding: 6,185 in 2019 and 6,175 in 2018	31	31
Additional paid-in capital	31,809	31,523
Accumulated deficit	(1,916)	(1,326)
Less - Treasury stock, at cost, 668 shares	(10,082)	(10,082)
Accumulated other comprehensive loss	(1,365)	(1,399)
Total Shareholders' Equity	18,477	18,747
Total Liabilities and Shareholders' Equity	$ 25,135	$ 24,974

See accompanying notes to condensed consolidated financial statements

PSYCHEMEDICS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(in thousands, except per share amounts)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenues	$ 9,289	$ 10,787	$ 19,111	$ 21,722
Cost of revenues	5,120	5,615	10,534	11,195
Gross profit	4,169	5,172	8,577	10,527
Operating Expenses:				
General & administrative	1,355	1,457	3,270	3,308
Marketing & selling	1,088	1,301	2,217	2,540
Research & development	400	358	820	717
Total Operating Expenses	2,843	3,116	6,307	6,565
Operating income	1,326	2,056	2,270	3,962
Other income, net	22	24	48	56
Net income before provision for income taxes	1,348	2,080	2,318	4,018
Provision for income taxes	580	903	923	1,590
Net income	$ 768	$ 1,177	$ 1,395	$ 2,428
Other Comprehensive Income (Loss):				
Foreign currency translation	82	(1,154)	34	(1,165)
Total Comprehensive Income	$ 850	$ 23	$ 1,429	$ 1,263
Basic net income per share	$ 0.14	$ 0.21	$ 0.25	$ 0.44
Diluted net income per share	$ 0.14	$ 0.21	$ 0.25	$ 0.44
Dividends declared per share	$ 0.18	$ 0.18	$ 0.36	$ 0.36
Weighted average common shares outstanding, basic	5,514	5,502	5,510	5,497
Weighted average common shares outstanding, diluted	5,523	5,554	5,535	5,552

See accompanying notes to condensed consolidated financial statements

PSYCHEMEDICS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands, except per share amounts)
(UNAUDITED)

	Common Stock			Treasury Stock			Accumulated Other	
	Shares	$0.005 par Value	Paid-In Capital	Shares	Cost	Accumulated Deficit	Comprehensive Income/(Loss)	Total
BALANCE, December 31, 2018	6,175	$ 31	$ 31,523	668	$ (10,082)	$ (1,326)	$ (1,399)	$ 18,747
Shares issued – vested	10	—	—	—	—	—	—	—
Tax withholding related to employee stock vesting	—	—	(33)	—	—	—	—	(33)
Stock compensation expense	—	—	319	—	—	—	—	319
Cash dividends ($0.36 per share)	—	—	—	—	—	(1,985)	—	(1,985)
Net income	—	—	—	—	—	1,395	—	1,395
Other comprehensive income	—	—	—	—	—	—	34	34
BALANCE, June 30, 2019	6,185	$ 31	$ 31,809	668	$ (10,082)	$ (1,916)	$ (1,365)	$ 18,477
BALANCE, December 31, 2017	6,160	$ 31	$ 31,022	668	$ (10,082)	$ (2,113)	$ (238)	$ 18,620
Shares issued – vested	15	—	—	—	—	—	—	—
Tax withholding related to employee stock vesting	—	—	(92)	—	—	—	—	(92)
Stock compensation expense	—	—	278	—	—	—	—	278
Cash dividends ($0.33 per share)	—	—	—	—	—	(1,812)	—	(1,812)
Net income	—	—	—	—	—	2,428	—	2,428
Other comprehensive loss	—	—	—	—	—	—	(1,165)	(1,165)
BALANCE, June 30, 2018	6,175	$ 31	$ 31,208	668	$ (10,082)	$ (1,497)	$ (1,403)	$ 18,257

See accompanying notes to condensed consolidated financial statements

PSYCHEMEDICS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(UNAUDITED)

	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,395	$ 2,428
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,501	1,528
Deferred income taxes	(58)	(105)
Non-cash interest income	36	—
Stock-based compensation	319	278
Changes in assets and liabilities:		
Accounts receivable	303	(857)
Other current assets	(633)	(253)
Accounts payable	(428)	322
Accrued expenses and accrued income taxes	(745)	259
Net cash provided by operating activities	1,690	3,600
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from short-term investments	3,810	—
Purchases of equipment and leasehold improvements	(165)	(281)
Cost of internally developed software	(191)	(152)
Other assets	14	(102)
Net cash provided by / (used in) investing activities	3,468	(535)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of stock, net of tax withholding	(33)	(92)
Payments of equipment financing	(207)	(478)
Cash dividends paid	(1,985)	(1,812)
Net cash used in financing activities	(2,225)	(2,382)
Effect of exchange rate changes on cash and cash equivalents	95	(1,127)
Net increase (decrease) in cash and cash equivalents	3,028	(444)
Cash and cash equivalents, beginning of period	4,069	8,165
Cash and cash equivalents, end of period	$ 7,097	$ 7,721
Supplemental Disclosures of Cash Flow Information:		
Cash paid for income taxes	$ 1,499	$ 1,910
Cash paid for interest	$ 38	$ 56
Cash paid for operating leases	$ 523	$ 502
Right-of-use assets acquired through operating leases	$ 1,927	$ —
Purchases of equipment through accounts payable and accrued liabilities	$ 450	$ 397

See accompanying notes to condensed consolidated financial statements

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

The interim condensed consolidated financial statements of Psychemedics Corporation (the "Company") presented herein, have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all the information and note disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2018, included in the Company's 2018 Annual Report on Form 10-K ("10-K"), as filed with the Securities and Exchange Commission.

The condensed consolidated balance sheet as of June 30, 2019, the condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2019 and 2018, the condensed consolidated statements of shareholders' equity for the six-month periods ended June 30, 2019 and 2018 and the condensed consolidated statements of cash flows for the six-month periods ended June 30, 2019 and 2018 are unaudited but, in the opinion of management, include all adjustments necessary for a fair presentation of results for these interim periods. The condensed consolidated balance sheet as of December 31, 2018 has been derived from the Company's annual financial statements that were audited by an independent registered public accounting firm but does not include all of the information and footnotes required for complete annual financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The results of operations for the three months and six months ended June 30, 2019 may not be indicative of the results that may be expected for the year ending December 31, 2019, or any other period.

Unless the context requires otherwise, the terms "we", "us", "our", or "the Company" refer to Psychemedics Corporation and its consolidated subsidiaries.

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 consisted exclusively of cash in the bank and bank certificates of deposits.

3. Marketable Securities

All investments with original maturities of more than 90 days are considered marketable securities. As of June 30, 2019, the Company had no marketable securities.

4. Fair Value Measurements

The Company has financial instruments, such as accounts receivable, accounts payable, and accrued expenses, which are stated at carrying amounts that approximate fair value because of the short maturity of those instruments. The carrying amount of the Company's long-term debt approximates fair value as the interest rate on the debt approximates the estimated borrowing rate currently available to the Company.

5. Stock-Based Compensation

The Company's 2006 Incentive Plan ("the Plan") provides for cash-based awards or the grant or issuance of stock-based awards. As of December 31, 2018, 77 thousand shares remained available for future grant under the 2006 Plan. At the 2019 annual meeting, an additional 350 thousand shares were approved for grant. There were no other changes to the plan as described in the 10-K. As of June 30, 2019, 221 thousand shares remained available for future grant under the Plan.

Share-based compensation is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant). The compensation cost charged against income is included in cost of revenues and operating expenses as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Share-based compensation related to:				
Stock option grants	$ 119	$ 73	$ 221	$ 131
Restricted Stock Unit awards ("RSUs")	42	70	98	147
Total share-based compensation	$ 161	$ 143	$ 319	$ 278

There was no income tax benefit recognized in the condensed consolidated statements of income for share-based compensation arrangements for the three-month or six-month periods ended June 30, 2019 and 2018.

5. Stock-Based Compensation (continued)

A summary of the Company's stock option activity for the six months ended June 30, 2019 is as follows (in 000's except per share amounts):

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value(1)
Outstanding, December 31, 2018	398	$ 17.09	8.2 years	$ 493
Granted	192	$ 10.60		
Exercised	—			
Forfeited	—			
Outstanding, June 30, 2019	590	$ 14.98	8.4 years	$ —
Exercisable, June 30, 2019	239	$ 14.55	7.4 years	$ —

(1) 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 June 30, 2019 ($10.09) exceeded the exercise price of the underlying options, multiplied by the number of shares subject to each option.

A summary of the Company's stock unit award ("SUA") activity for the six months ended June 30, 2019 is as follows (in 000's except per share amounts):

	Number of Shares	Weighted Average Price per Share (2)	Weighted Average Fair Value (2)
Outstanding & Unvested, December 31, 2018	19	$ 18.20	$ 343
Granted	18	$ 10.60	$ 191
Converted to common stock	(10)		
Cancelled	(3)		
Forfeited	—		
Outstanding & Unvested, June 30, 2019	24	$ 12.84	$ 311

(2) Weighted average price per share is the weighted grant price based on the closing market price of each of the stock grants related to each grant of stock unit awards. The weighted average fair value is the weighted average share price times the number of shares.

As of June 30, 2019, a total of 835 thousand shares of common stock were reserved for issuance under the Plan. As of June 30, 2019, the unamortized fair value of awards relating to outstanding SUAs and options was $1.6 million, which is expected to be amortized over a weighted average period of 3.1 years.

6. 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 was determined in accordance with the treasury-stock method. Common equivalent shares consisted of common stock issuable upon the exercise of outstanding options and common stock issuable upon the vesting of outstanding, unvested SUAs. Basic and diluted weighted average common shares outstanding for the three months and six months ended June 30, 2019 and 2018 were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	**2018**	**2019**	**2018**
Weighted average common shares outstanding, basic	5,514	5,502	5,510	5,497
Dilutive common equivalent shares	9	52	25	55
Weighted average common shares outstanding, diluted	5,523	5,554	5,535	5,552

The computation of diluted earnings per share for the three and six month periods ended June 30, 2019 excludes the effect of the potential exercise of stock awards, including stock options, when the average market price of the common stock is lower than the exercise price of the related options during the period. These stock awards are not included in the computation of diluted income per share because the effect would be antidilutive. For the three and six month periods ended June 30, 2019, the number of antidilutive stock awards excluded from the diluted earnings per share was 357 thousand and 246 thousand, respectively.

7. Commitments and Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. While the ultimate outcome of individual legal claims is inherently unpredictable, we believe that the final resolution of any pending actions will not have a material adverse effect on our results of operations, financial position, liquidity or capital resources.

8. Operating Leases

The Company has six operating leases for office and laboratory space used to conduct business (one of which is for a data center). The exercise of lease renewal options is at our discretion and the majority of renewals to extend the lease terms are not included in our Right-Of-Use ("ROU") assets and lease liabilities as they are not reasonably certain of exercise. The Company regularly evaluates the renewal options and when they are reasonably certain of exercise. The Company includes the renewal period in the lease term. As most of the Company's leases do not provide an implicit rate, the Company uses the incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments.

As of June 30, 2019, the Company recognized a Right-Of-Use ("ROU") asset with a corresponding operating lease liability of $1.4 million based on the present value of the minimum rental payments as a result of adoption of ASC Topic 842. The weighted average discount rate used for leases as of June 30, 2019 is 4.1%. The weighted average lease term as of June 30, 2019 is 2.0 years. The operating lease expense for the three and six months ended June 30, 2019 was $0.3 million and $0.5 million, respectively.

Maturities and balance sheet presentation of the Company's lease liabilities for all operating leases as of June 30, 2019 is as follows (in thousands):

2019	$	548
2020		648
2021		156
2022		116
2023		18
Total Lease Payments		1,486
Less Interest:		(70)
Present value of lease liabilities	$	1,416
Current operating lease liabilities	$	861
Long-term operating lease liabilities		555
Total	$	1,416

9. Debt and Other Financing Arrangements

On March 20, 2014, the Company entered into an equipment financing arrangement ("Loan Agreement") with Banc of America Leasing & Capital, which it amended on August 8, 2014, September 15, 2015 and October 30, 2018. The terms of the arrangement are detailed in the 10-K.

The weighted average interest rate on outstanding debt under the Loan Agreement was 4.2% for the three and six months ended June 30, 2019. The interest expense was $17 thousand and $32 thousand for the three and six months ended June 30, 2019, respectively. As of June 30, 2019, the interest rate was 4.2% and there was $1.4 million of outstanding debt related under the loan agreement. The Company was in compliance with all loan covenants as of June 30, 2019.

The annual principal repayment requirements for debt obligations as of June 30, 2019 were as follows (in 000's):

2019	$	208
2020		416
2021		416
2022		381
Total long-term debt		1,421
Less current portion of long-term debt		(416)
Total long-term debt, net of current portion	$	1,005

10. Revenue

The table below disaggregates our external revenue by major source (in thousands). For additional revenue detail relating to geographic breakdown of sales, see Note 11 – "Business Segment Reporting".

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Testing	$ 8,451	$ 9,864	$ 17,474	$ 19,896
Shipping/Collection (hair)	777	812	1,511	1,636
Other	61	111	126	190
Total Revenue	$ 9,289	$ 10,787	$ 19,111	$ 21,722

11. Business Segment Reporting

The Company manages its operations as one segment, drug testing services. As a result, the financial information disclosed herein materially represents all of the financial information related to the Company’s principal operating segment. All Brazil sales are through one independent distributor, which is the only customer greater than 10% of sales. The Company’s revenues by geographic region are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	**2018**	**2019**	**2018**
Consolidated Revenue:				
United States	$ 6,807	$ 7,565	$ 13,867	$ 14,860
Brazil	2,358	3,101	5,001	6,628
Other	124	121	243	234
Total Revenue	$ 9,289	$ 10,787	$ 19,111	$ 21,722

12. Significant Customers

The Company had one customer that represented 26% of revenue for the six months ended June 30, 2019 and 31% for the comparable period in 2018. The Company had two customers that represented 15% and 11% of the total accounts receivable balance as of June 30, 2019 and one customer that represented 20% of the total accounts receivable balance as of December 31, 2018.

13. Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases, which was subsequently amended by ASU 2018-10, ASU 2018-11, ASU 2018-20 and ASU 2019-01 (collectively, Topic 842). which introduced the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The new standard established a right-of-use ("ROU") model that requires a lessee to record a lease asset and liability on the balance sheet for all leases with terms longer than 12 months. The standard became effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company adopted Topic 842 as of January 1, 2019 (see Note 8 – Operating Leases).

In August 2018, the SEC issued Release No. 33-10532 that amended and clarified certain financial reporting requirements. The principal change to our financial reporting is the inclusion of the annual disclosure requirement of changes in stockholders’ equity to interim periods. We adopted this rule for the quarter ended March 31, 2019.

14. Accounting Pronouncements Issued But Not Yet Effective

In February 2018, the FASB issued ASU 2018-02, “Income Statement – Reporting Comprehensive Income” (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which will allow a reclassification from accumulated other comprehensive income to retained earnings for the tax effects resulting from the Tax Cuts and Jobs Act (Tax Reform Act) that are stranded in accumulated other comprehensive income. This standard also requires certain disclosures about stranded tax effects. ASU 2018-02, however, does not change the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations. ASU 2018-02 will be effective for the Company’s fiscal year 2020, with the option to early adopt prior to the effective date. It must be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized. The Company is currently evaluating the impacts the adoption of this accounting guidance will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software: Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract”. The FASB issued ASU 2018-15 to align the requirements for capitalizing implementation costs in a cloud computing arrangement service contract with the requirements for capitalizing implementation costs incurred for an internal-use software license. ASU 2018-15 will be effective for the Company’s fiscal year 2020, with the option to early adopt prior to the effective date. The Company is currently evaluating the impact that this updated standard will have on its consolidated financial statements.

15. Subsequent Events

On July 23, 2019, the Company declared a quarterly dividend of $0.18 per share for a total of $993 thousand, which will be paid on August 16, 2019 to shareholders of record on August 6, 2019.

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, profitability, margins, pricing, 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, foreign drug testing laws and regulations and the enforcement of such laws and regulations, including effective dates of such laws and regulations, required investments in plant, property and equipment, strategies with respect to governmental agencies and regulations, cost savings, capital expenditures, liquidity of investments, our relationship with our Brazilian distributor and market demand for drug testing services in Brazil 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 employee hiring practices of the Company's principal customers, development of markets for new products and services offered by the Company, costs associated with capacity expansion, government regulation (including, but not limited to, Food and Drug Administration regulations and foreign government regulation including Brazilian commercial drivers license drug test laws and regulations), risks associated with the delay in the implementation of new regulations, risks associated with foreign currency fluctuations, R&D spending, competition (including, without limitation, competition from other companies pursuing the same growth opportunities), the Company's ability to maintain its reputation and brand image, the ability of the Company to achieve its business plans, cost controls, leveraging of its global operating platform, risks of information technology system failures and data security breaches, the uncertain global economy, the Company's ability to attract, develop and retain executives and other qualified employees and independent contractors, including distributors, the Company's ability to obtain and protect intellectual property rights, litigation risks, 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, debt service obligations, and other factors that the Board of Directors of the Company may take into account.

Given these uncertainties, you should not place undue reliance on these forward-looking statements. Forward-looking statements represent the Company's estimates and assumptions only as of the filing date of this Report. The Company expressly disclaim any duty to provide updates to forward-looking statements, and the estimates and assumptions associated with them, after the filing date of this Report, in order to reflect changes in circumstances or expectations, or the occurrence of unanticipated events, except to the extent required by applicable securities laws. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed above and under "Risk Factors" set forth in Part I Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2018, as well as the risks and uncertainties discussed elsewhere in this Report. The Company qualifies all of its forward-looking statements by these cautionary statements. The Company cautions you that these risks are not exhaustive. The Company operates in a continually changing business environment and new risks emerge from time to time.

OVERVIEW

Revenue for the second quarter of 2019 was $9.3 million compared to $10.8 million in 2018, a decrease of 14%. The Company reported net income of $0.8 million, or $0.14 per diluted share for the three months ended June 30, 2019 versus $1.2 million, or $0.21 per diluted share for the same period in 2018, a decrease of 35%. The decrease in net income was primarily attributable to lower sales volume as compared to 2018. Revenue for the six months ended June 30, 2019 and 2018 was $19.1 million and $21.7 million, respectively, a decrease of 12%. Net income for the six months ended June 30, 2019 and 2018 was $1.4 million and $2.4 million, respectively, a decrease of 43%. The Company declared $0.36 per share of cash dividends to its shareholders in the six months ended June 30, 2019 compared to $0.36 for the same period in 2018. The Company has paid 91 consecutive quarterly cash dividends.

RESULTS OF OPERATIONS

Revenue decreased 14% for the three months ended June 30, 2019, primarily due to a 12% decrease in volume and a 2% negative impact from foreign currency exchange. Revenues from domestic business decreased 10%. Revenues from international business decreased 23%. Revenue decrease of 12% for the six months ended June 2019 was primarily due to a 9% decrease in volume and a 3% negative impact from foreign currency exchange. Revenues from domestic business decreased 7%. Revenues from international business decreased 24%.

Gross profit decreased 19% or $1.0 million to $4.2 million for the three months ended June 30, 2019, compared to $5.2 million for the same period in 2018. Direct costs decreased by $0.5 million or 9% for the three months ended June 30, 2019 compared to the same period in 2018. The gross profit margin was 45% and 48% for the three months ended June 30, 2019 and 2018, respectively. Gross profit for the six months ended June 30, 2019 decreased $2.0 million to $8.6 million for the comparable period in 2018. Direct costs decreased by $0.7 million or 6% for the six months ended June 30, 2019 when compared to the same period in 2018. The gross profit margin for the six month period ended June 30, 2019 was 45% compared to 48% for the comparable period in 2018. The decrease was primarily driven by the impact from lower revenue volume and from an unfavorable currency exchange.

General and administrative *("G&A")* ***expenses*** decreased 7% or $0.1 million to $1.4 million for the three months ended June 30, 2019 compared to $1.5 million for the same period in 2018. As a percentage of revenue, G&A expenses were 15% and 14% for the three months ended June 30, 2019 and 2018, respectively. General and administrative expenses were $3.3 million for the six months ended June 30, 2019 and 2018. As a percentage of revenue, G&A expenses were 17% and 15% for the six months ended June 30, 2019 and 2018, respectively.

Marketing and selling expenses decreased 16% or $0.2 million to $1.1 million for the three months ended June 30, 2019 compared to $1.3 million for the same period in 2018. Total marketing and selling expenses represented 12% of revenue for the three months ended June 30, 2019 and 2018. Marketing and selling expenses were $2.2 million and $2.5 million for the six months ended June 30, 2019 and 2018, respectively. As a percentage of revenue, marketing and selling expenses were 12% for the six months ended June 30, 2019 and 2018.

Research and development** (“R&D”) **expenses for the three months ended June 30, 2019 and 2018 were $0.4 million. R&D expenses represented 4% and 3% of revenue for the three months ended June 30, 2019 and 2018, respectively. R&D expenses were $0.8 million and $0.7 million for the six months ended June 30, 2019 and 2018, respectively. R&D expenses represented 4% and 3% of revenue for the six months ended June 30, 2019 and 2018, respectively.

Provision for income taxes consists primarily of federal and state income taxes in the United Sates and income taxes in Brazil. We estimate income taxes in each of the jurisdictions in which we operate. During the three months ended June 30, 2019 and 2018, the Company recorded tax provisions of $0.6 million and $0.9 million, respectively. These provisions represented an effective tax rate of 43% for the three months ended June 30, 2019 and 2018. During the six months ended June 30, 2019 and 2018, the Company recorded tax provisions of $0.9 million and $1.6 million, respectively. These provisions represented an effective tax rate of 40% for the six months ended June 30, 2019 and 2018. The Company currently expects the year-end tax rate to be approximately 40%. This rate can fluctuate significantly based on the mix of business and pre-tax income, as Brazil income taxes are based on revenue.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2019, the Company had approximately $7.1 million of cash and cash equivalents and $9.1 million of working capital. The Company's operating activities generated net cash of $1.7 million for the six months ended June 30, 2019. Investing activities provided $3.5 million of cash while financing activities used $2.2 million of cash during the first six months of 2019.

Cash provided by operating activities of $1.7 million reflected net income of $1.4 million adjusted for depreciation and amortization of $1.5 million, stock-based compensation of $0.3 million and a decrease of deferred income taxes of $0.1 million. This was affected by an increase in current assets of $0.3 million and a decrease in current liabilities of $1.2 million.

Cash provided by investing activities of $3.5 million reflected the sale of marketable securities of $3.8 million, purchases of equipment and leasehold improvements of $0.2 million and cost of internally developed software of $0.2 million. We anticipate spending less than $1.0 million in additional capital purchases for the remainder of 2019.

Cash used by financing activities of $2.2 million included cash dividends to shareholders of $2.0 million and $0.2 million from long-term debt payments.

Contractual obligations and other commercial commitments as of June 30, 2019 include operating lease commitments and outstanding debt, described in Notes 8 and 9, respectively of the Notes to Condensed Consolidated Financial Statements.

At June 30, 2019, the Company's principal sources of liquidity included an aggregate of approximately $7.1 million of cash and cash equivalents. The Company had $9.1 million and $9.8 million of working capital as of June 30, 2019 and December 31, 2018, respectively. The new lease accounting standard negatively impacted the working capital amount by $0.9 million. Management currently believes that such funds should be adequate to fund anticipated working capital and capital equipment requirements for the next 12 months. Depending upon the Company's results of operations and capital needs, the Company may use various financing sources to raise additional funds.

Brazilian Distributor Risks and Uncertainties

As the Company has previously disclosed, there are greater challenges and uncertainties in a new, large and developing market, such as Brazil. Psychemedics Brasil, our independent distributor in Brazil, has had 55% of its shares acquired by Instituto Hermes Pardini S.A., a provider of medical and diagnostic services in Brazil, including reference laboratory services. We are continuing our discussions with our distributor and its acquirer about the future of our distribution agreement (which either party may terminate upon prior written notice following July 2019), including whether it will be extended, terminated or replaced by a transition agreement for us to continue to sell our drug tests to our current distributor for a period of time. The outcome of these discussions is not certain, and any significant decrease in sales to our distributor would have a materially adverse impact on our business. However, we believe that the overall market demand for drug testing services in Brazil will continue to grow, and it remains uncertain whether the acquirer will have the capacity to supply our distributor with the volume of drug tests that we currently provide, at least in the near term. At the same time, we have also been exploring additional options in Brazil.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report (the "evaluation date") the Company's management under the supervision and with the participation of the Company's Chief Executive Officer and Vice President of Finance, performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act. Based upon that evaluation, the Chief Executive Officer and Vice President - Finance concluded as of the evaluation date, that the Company's disclosure controls and procedures were effective for ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that its disclosure controls and procedures were also effective to ensure that information required to be disclosed in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the Company's principal executive and principal financial officers, to allow timely decisions regarding required disclosure.

There has been no significant change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2018 Annual Report on Form 10-K.

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

There were no purchases of treasury stock in the first six months of 2019.

Item 6. Exhibits

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
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase

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: July 24, 2019 By: /s/ Raymond C. Kubacki
Raymond C. Kubacki
Chairman and Chief Executive Officer
(principal executive officer)

Date: July 24, 2019 By: /s/ Neil L. Lerner
Neil L. Lerner
Vice President - Finance
(principal accounting officer)

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Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

**CERTIFICATION PURSUANT TO
SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Raymond C. Kubacki, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Psychemedics Corporation (“the registrant”);

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this

quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined by Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 24, 2019

/s/ Raymond C. Kubacki
Raymond C. Kubacki
Chairman and Chief Executive Officer
(principal executive officer)

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Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATION PURSUANT TO
SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, Neil Lerner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Psychemedics Corporation ("the registrant");

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined by Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of

financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting;

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors:

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: July 24, 2019

/s/ Neil Lerner
Neil Lerner
Vice President - Finance
(principal accounting officer)

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Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

CERTIFICATION PURSUANT TO
U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Raymond C. Kubacki, Chairman and Chief Executive Officer of Psychemedics Corporation (the “Company”), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as the principal executive officer of the Company, that:

(1) The Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2019, as filed with the Securities and Exchange Commission on July 24, 2019 (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 24, 2019

/s/ Raymond C. Kubacki
Raymond C. Kubacki
Chairman and Chief Executive Officer
(principal executive officer)

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Section 5: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

CERTIFICATION PURSUANT TO
U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Neil Lerner, Vice President - Finance of Psychemedics Corporation (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as the principal accounting officer of the Company, that:

(1) The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2019, as filed with the Securities and Exchange Commission on July 24, 2019 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 24, 2019

/s/ Neil Lerner
Neil Lerner
Vice President - Finance
(principal accounting officer)

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