PSYCHEMEDICS CORP
Form 10-K
March 08, 2013

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

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2012

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934

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, Massachusetts **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:

Common Stock, $0.005 par value

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by a check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Exchange Act of 1934). Yes o No x

Indicate by a check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934). Yes o No x

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer” and “large accelerated filer” in Rule 12b-2 of the Securities Exchange Act of 1934.

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer o Smaller Reporting Company x (Do not check if a smaller reporting company)

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

As of June 30, 2012, there were 5,272,428 shares of Common Stock of the Registrant outstanding. The aggregate market value of the Common Stock of the Registrant held by non-affiliates (assuming for these purposes, but not conceding, that all executive officers, directors and 5% shareholders are “affiliates” of the Registrant) as of June 30, 2012 was approximately $38 million, computed based upon the closing price of $10.29 per share on June 30, 2012.

As of February 25, 2013, there were 5,272,428 shares of Common Stock of the Registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates by reference portions of the Registrant’s definitive proxy statement, to be filed with the Securities and Exchange Commission no later than 120 days after the close of its fiscal year; provided that if such proxy statement is not filed with the Commission in such 120-day period, an amendment to this Form 10-K shall be filed no later than the end of the 120-day period.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under “Business,” “Risk Factors,” “Legal Proceedings,” “Market for Registrant’s Common Stock and Related Stockholder Matters” and “Management Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Annual Report on Form 10-K (this “Form 10-K”) constitute forward-looking statements under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements made with respect to future earnings per share, future revenues, future operating income, future cash flows, competitive and strategic initiatives, potential stock repurchases and future liquidity needs. These statements involve known and unknown risks, uncertainties and other factors that may cause results, levels of activity, growth, performance, earnings per share or achievements to be materially different from any future results, levels of activity, growth, performance, earnings per share or achievements expressed or implied by such forward-looking statements.

The forward-looking statements included in this Form 10-K and referred to elsewhere are related to future events or our strategies or future financial performance. In some cases, you can identify forward-looking statements by terminology such as “may,” “should,” “believe,” “anticipate,” “future,” “potential,” “estimate,” “encourage,” “opportunity,” “g “leader,” “could”, “expect,” “intend,” “plan,” “expand,” “focus,” “through,” “strategy,” “provide,” “offer,” “allow,” “commitm “result,” “increase,” “establish,” “perform,” “make,” “continue,” “can,” “ongoing,” “include” or the negative of such terms or c terminology. All forward-looking statements included in this Form 10-K are based on information available to us as of the filing date of this report, and the Company assumes no obligation to update any such forward-looking statements. Our actual results could differ materially from the forward-looking statements. Important factors that could cause actual results to differ materially from expectations reflected in our forward-looking statements include those described in Item 1A, “Risk Factors.”

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ANNUAL REPORT
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PART I

Available Information; Background

Psychemedics Corporation ("the Company" or "Psychemedics") maintains executive offices located at 125 Nagog Park, Acton, MA 01720. Our telephone number is (978) 206-8220. Our stock is traded on the NASDAQ Stock Exchange Market under the symbol "PMD". Our Internet address is *www.psychemedics.com*. The Company makes available, free of charge, on the Investor Information section of its website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (the "SEC"). Copies are also available, without charge, from Psychemedics Corporation, Attn: Investor Relations, 125 Nagog Park, Acton, MA 01720. Alternatively, reports filed with the SEC may be viewed or obtained at the SEC Public Reference Room in Washington, D.C., or the SEC's Internet site at *www.sec.gov*. We do not intend for information contained in our website to be part of this Annual Report on Form 10-K.

Item 1. Business

General

Psychemedics Corporation is a Delaware corporation organized on September 24, 1986 to provide testing services for the detection of drugs of abuse through the analysis of hair samples. The Company's testing methods utilize a patented technology that focuses on liquefying hair and releasing drugs trapped in the hair without destroying the drugs. This is fundamental to the entire process because the patented method gets virtually 100% of the drug out of the hair, and if you cannot get the drug out of the hair, you cannot measure it. The Company then performs a proprietary custom-designed enzyme immunoassay (EIA) on the precipitate, with confirmation testing by mass spectrometry.

The Company's primary application of its patented technology is as a testing service that analyzes hair samples for the presence of certain drugs of abuse. The Company's customized proprietary EIA procedures to drug test hair samples differ from the more commonly-used immunoassay procedures employed to test urine samples. The Company's tests provide quantitative information that can indicate the approximate amount of drug ingested as well as historical data, which can show a pattern of individual drug use over a longer period of time, thereby providing superior detection compared to other types of drug testing. This information is useful to employers for both applicant and employee testing, as well as to physicians, treatment professionals, law enforcement agencies, school administrators, and parents concerned about their children's drug use. The Company provides screening and confirmation by mass spectrometry using industry-accepted practices for cocaine, marijuana, PCP, amphetamines (including ecstasy) and opiates (including heroin, hydrocodone, hydromorphone, oxycodone and codeine).

Testing services are currently performed at the Company's laboratory at 5832 Uplander Way, Culver City, California.

Development of Testing Method for Drugs of Abuse Using Hair

The analysis of drugs in the hair was initially developed in 1978 by the founders of the Company, Annette Baumgartner and Werner A. Baumgartner, Ph.D. The Baumgartners demonstrated that when certain chemical substances enter the bloodstream, the blood carries these substances to the hair where they become “entrapped” in the protein matrix in amounts approximately proportional to the amount ingested. The Company initially utilized a patented drug extraction method followed by a unique radioimmunoassy (RIAH) procedure to identify drugs in the hair. In 2011, the Company developed a new patented method, which it is currently using, for drug extraction. This patent covers the efficient liquefaction of hair and release of the drugs without destroying the drugs—getting virtually 100% of the drug out of the hair. The new patented method can be used with a broad range of immunoassay screen techniques, mass spectrometry methods, and chromatographic procedures.

In 2012, the Company developed its current custom designed enzyme immunoassay (EIA) test to replace the RIAH test. In its 510k filing with the U.S. Food and Drug Administration (FDA), the Company demonstrated to the FDA’s satisfaction, that the new EIA assay is substantially equivalent to the RIAH assay. This is significant as the RIAH process set the standard for its sensitivity, robustness and consistency. The newly developed immunoassays produced by the Psychemedics R&D team were uniquely designed specifically to meet and even exceed the standards of radioimmunoassay, and represent a significant technological breakthrough. Because Psychemedics is the only hair testing laboratory that manufactures its own screening assays, it has full control over all aspects of its technology, and that powerful advantage facilitated the Company's creation of the new assays with equivalence to its own previously FDA-cleared radioimmunoassays.

The EIA screened positive results are then confirmed by mass spectrometry. Depending upon the length of hair, the Company is able to provide historical information on drug use by the person from whom the sample was obtained. Because head hair grows approximately 1.3 centimeters per month, a 3.9 centimeter head hair sample can reflect drug ingestion over the approximate three months prior to the collection of the sample. Another option is sectional analysis of the head hair sample, in which the hair is sectioned lengthwise to approximately correspond to certain time periods, thereby providing information on patterns of drug use.

Validation of the Company's Proprietary Testing Methods

The process of analyzing human hair for the presence of drugs has been the subject of numerous peer-reviewed, scientific field studies. The results from the studies have been published or accepted for publication in scientific journals have been generally favorable to the Company's technology. Some of these studies were performed with the following organizations: Boston University School of Public Health; Citizens for a Better Community Court, Columbia University; Connecticut Department of Mental Health and Addictive Services; Koba Associates-DC Initiative, Harvard Cocaine Recovery Project; Hutzel Hospital, ISA Associates (Interscience America)-NIDA Workplace Study; University of California-Sleep State Organization; Maternal/Child Substance Abuse Project, Matrix Center, National Public Services Research Institute, Narcotic and Drug Research Institute, San Diego State University-Chemical Dependency Center, Spectrum Inc.; Stapleford Centre (London); Task Force on Violent Crime (Cleveland, Ohio); University of Miami-Department of Psychiatry, University of Miami-Division of Neonatology; University of South Florida-Operation Par Inc.; University of Washington, VA Medical Center-Georgia; U.S. Probation Parole-Santa Ana; and Wayne State University. The above studies included research in the following areas: effects of prenatal drug use, treatment evaluation, workplace drug use, the criminal justice system and epidemiology. Many of the studies have been funded by the National Institute of Justice or the National Institute on Drug Abuse ("NIDA"). Several hundred research articles written by independent researchers have been published supporting the general validity and usefulness of hair analysis.

Some of the Company's customers have also completed their own testing to validate the Company's hair test results compared to other companies' urine test results. These studies consistently confirmed the Company's superior detection rate compared to urinalysis testing. When results from the Company's hair testing methods were compared to urine results in side-by-side evaluations, 4 to 10 times as many drug abusers were accurately identified by the Company's proprietary methods.

In 1998, the National Institute of Justice, utilizing Psychemedics' RIAH hair testing assay, completed a Pennsylvania Prison study where hair analysis revealed an average prison drug use level of approximately 7.9% in 1996. Comparatively, urinalysis revealed virtually no positives. After measures to curtail drug use were instituted (drug-sniffing dogs, searches and scanners), the use level fell to approximately 2% according to the results of hair analysis in 1998. Again, the urine tests showed virtually no positives. The study illustrates the usefulness of hair analysis to monitor populations and the weakness of urinalysis.

The Company has received 510k clearance from the FDA on all five of its assays used to test head and body hair for drugs of abuse. As of the date of this document, Psychemedics is the only company to receive FDA clearance for testing of drugs of abuse using both head and body hair.

Advantages of Using the Company's Patented Method

The Company asserts that hair testing using its patented method confers substantive advantages over detection through urinalysis. Although urinalysis testing can provide accurate drug use information, the scope of the information is short-term and is generally limited to the type of drug ingested within a few days of the test. Studies published in many scientific publications have indicated that most drugs disappear from urine within a few days.

In contrast to urinalysis testing, hair testing using the Company's patented method can provide long-term historical drug use information resulting in a significantly wider window of detection. This window may be several months or longer depending on the length of the hair sample. The Company's standard test offering, however, uses a 3.9 centimeter length head hair sample cut close to the scalp which measures use for approximately three months prior to collection of the sample.

This wider window enhances the detection efficiency of hair analysis, making it particularly useful in pre-employment and random testing. Hair testing not only identifies more drug users, but it may also uncover patterns and severity of drug use (information most helpful in determining the scope of an individual's involvement with drugs), while serving as a deterrent against drug use. Hair testing employing the Company's patented method greatly reduces the incidence of "false negatives" associated with evasive measures typically encountered with urinalysis testing. For example, urinalysis test results are adversely impacted by excessive fluid intake prior to testing and by adulteration or substitution of the urine sample. Moreover, a drug user who abstains from use for a few days prior to urinalysis testing can usually escape detection. Hair testing is effectively free of these problems, as it cannot be thwarted by evasive measures typically encountered with urinalysis testing. Hair testing is also attractive to customers since sample collection is typically performed under close supervision yet is less intrusive and less embarrassing for test subjects.

Hair testing using the Company's patented method (with mass spectrometry confirmation) further reduces the prospects of error in conducting drug detection tests. Urinalysis testing is more susceptible to problems such as "evidentiary false positives" resulting from passive drug exposure or poppy seeds. To combat this problem, in federally mandated testing, the opiate cutoff levels for urine testing were raised 667% (from 300 to 2,000 ng/ml) on December 1, 1998, and testing for the presence of a heroin metabolite, 6-AM, was required. These requirements, however, effectively reduced the detection time frame for confirmed heroin with 6-AM in urine down to several hours post drug use. In contrast, the metabolite 6-AM is stable in hair and can be detected for months.

In the event a positive urinalysis test result is challenged, a test on a newly collected urine sample is not a viable remedy. Unless the forewarned individual continues to use drugs prior to the date of the newly collected sample, a re-test may yield a negative result when using urinalysis testing because of temporary abstinence. In contrast, when the Company's hair testing method is offered on a repeat hair sample, the individual suspected of drug use cannot as easily affect the results because historical drug use data remains locked in the hair fiber.

When compared to other hair testing methods, not only are the Company's assays cleared by the FDA for head and body hair, they also employ a unique patented method of liquefying hair that the Company believes allows for the most efficient release of drugs from the hair without destroying the drugs. The Company's method of releasing drugs from hair is a key advantage and results in superior detection rates.

Disadvantages of Hair Testing

There are some disadvantages of hair testing as compared to drug detection through urinalysis. Because hair starts growing below the skin surface, drug ingestion evidence does not appear in hair above the scalp until approximately five to seven days after use.

Thus, hair testing is not suitable for determining drug presence in "for cause" testing as is done in connection with an accident investigation. It does, however, provide a drug history which can complement urinalysis information in "for cause" testing.

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The Company's prices for its tests are generally somewhat higher than prices for tests using urinalysis, but the Company believes that its superior detection rates provide more value to the customer. This pricing policy could, however, adversely impact the growth of the Company's sales volume.

Intellectual Property

Certain aspects of the hair analysis method currently used by the Company are covered by US and foreign patents owned by the Company. The Company has been granted a total of eight US patents. On December 27, 2011, a patent was issued to the Company that focuses on liquefying hair and releasing drugs trapped in the hair without destroying the drugs. The new patented method can be used with a broad range of immunoassay screen techniques, mass spectrometry methods, and chromatographic procedures. On December 11, 2012, the company received an additional patent that extended the range of the patent received in 2011 for the liquefying of hair.

The Company also relies on trade secrets to protect certain aspects of its proprietary technology. The Company's ability to protect the confidentiality of its trade secrets is dependent upon the Company's internal safeguards and upon the laws protecting trade secrets and unfair competition.

In the event that patent protection or protection under the laws of trade secrets is not sufficient and the Company's competitors succeed in duplicating the Company's products, the Company's business could be materially adversely affected.

Target Markets

Workplace

The Company focuses its primary marketing efforts on the private sector, with particular emphasis on job applicant and employee testing.

Most businesses use drug testing to screen job applicants and employees. The Hazeldon Foundation survey from 2007 indicated that 85 percent of human resource ("HR") professionals believe that drug testing is an effective way to diagnose substance abuse. The prevalence of drug screening programs reflects a concern that drug use contributes to employee health problems and costs (as the same study found that 62 percent of HR professionals believe that absenteeism is the most significant problem caused by substance abuse and addiction, followed at 49 percent by reduced productivity, a lack of trustworthiness at 39 percent, a negative impact on the company's external image at 32 percent, missed deadlines at 31 percent, and in certain industries, safety hazards.) It has been estimated that the cost to American businesses is more than $100 billion annually.

The principal criticism of employee drug testing programs centers on the effectiveness of the testing program. Most private sector testing programs use urinalysis. Such programs are susceptible to evasive maneuvers and the inability to obtain confirmation through repeat samples in the event of a challenged result. An industry has developed over the Internet, and through direct mail, marketing a wide variety of adulterants, dilutants, clean urine and devices to assist drug users in falsifying urine test results.

Moreover, scheduled tests such as pre-employment testing and some random testing programs provide an opportunity for many drug users to simply abstain for a few days in order to escape detection by urinalysis.

The Company presents its patented hair analysis method to potential clients as a better technology well suited to employer needs. Field studies and actual client results support the accuracy and effectiveness of the Company's patented technology and its ability to detect varying levels of drug use. This information provides an employer with greater flexibility in assessing the scope of an applicant's or an employee's drug problem.

The Company performs a confirmation test of all screened positive results through mass spectrometry. The use of mass spectrometry is an industry accepted practice used to confirm a positive test result from the screening process. The Company offers its clients a five-drug screen with mass spectrometry confirmation of cocaine, PCP, marijuana, amphetamines (including Ecstasy), and opiates (including heroin and oxycodone).

Schools

The Company currently serves hundreds of schools throughout the United States and in several foreign countries. The Company offers its school clients the same five-drug screen with mass spectrometry confirmation that is used with the Company's workplace testing service.

Parents

The Company also offers a personal drug testing service, known as "PDT-90"®, for parents concerned about drug use by their children. It allows parents to collect a small sample from their child in the privacy of the home, send it to the Company's laboratory and have it tested for drugs of abuse by the Company. The PDT-90 testing service uses the same patented method that is used with the Company's workplace testing service.

Research

The Company is involved in the following ongoing studies involving use of drugs of abuse in various populations: Boston Medical Center; Boston University School of Public Health; University of North Carolina - Chapel Hill; Johns Hopkins Bloomberg School of Public Health; Mclean Hospital; Wayne State University and Chemistry and Drug Metabolism Section, NIDA; and Emmes Corporation.

Sales and Marketing

The Company markets its corporate drug testing services primarily through its own sales force and through distributors. Sales offices are located in several major cities in the United States in order to facilitate communications with corporate employers. The Company markets its home drug testing service, PDT-90, through the Internet.

Competition

The Company competes directly with numerous commercial laboratories that test for drugs primarily through urinalysis testing. Most of these laboratories, such as Quest Diagnostics, have substantially greater financial resources, market identity, marketing organizations, facilities, and more personnel than the Company. The Company has been steadily increasing its base of corporate customers and believes that future success with new customers is dependent on the Company's ability to communicate the advantages of implementing a drug program utilizing the Company's patented hair analysis method.

The Company's ability to compete is also a function of pricing. The Company's prices for its tests are generally somewhat higher than prices for tests using urinalysis. However, the Company believes that its superior detection rates, coupled with the customer's ability to test less frequently due to hair testing's wider window of detection (several months versus approximately three days with urinalysis), provide more value to the customer. This pricing policy could, however, lead to slower sales growth for the Company.

The Company also competes with other hair testing laboratories. The Company distinguishes itself from hair testing competitors by emphasizing the superior results the Company obtains through use of its unique patented extraction method (getting drug out of the hair), in combination with the Company's FDA cleared immunoassay screen.

In addition, Psychemedics is the only laboratory with FDA clearance for a five-drug panel test that is not limited to head hair samples for drugs of abuse. To date, no other laboratory engaged in hair testing has received approval or clearance from the FDA on all of its assays for the testing of both head and body hair samples (two other laboratories have either partial FDA clearance or clearance specific to head hair samples only).

Government Regulation

The Company is licensed as a clinical laboratory by the State of California as well as certain other states. All tests are performed according to the laboratory standards established by the Department of Health and Human Services, through the Clinical Laboratories Improvement Amendments ("CLIA"), and various state licensing statutes.

A substantial number of states regulate drug testing. The scope and nature of such regulations varies greatly from state to state and is subject to change from time to time. The Company addresses state law issues on an ongoing basis.

In 2000, the FDA issued regulations under the Federal Food, Drug and Cosmetic Act, as amended (the "FDC Act") with respect to companies that market "drugs of abuse test sample collection systems". Under the regulations, companies engaged in the business of testing for drugs of abuse using a test (screening assay) not previously recognized by the FDA are required to submit their assay to the FDA for recognition prior to marketing. In addition, the laboratory performing the tests is required to be certified by a recognized agency. The regulations included a transitional period

in order for companies not immediately in compliance with the proposed requirements to obtain the necessary data they needed for submission to the FDA. By May 2002, the Company had received 510k clearance to market all five of its assays utilizing RIAH technology.

In June 2008, Psychemedics also received the first CAP (College of American Pathologists) certification specifically including hair testing.

In November 2011, the Company received ISO/IEC 17025 International Accreditation for a broad spectrum of laboratory testing including drugs of abuse and forensics in hair and urine specimens. ISO/IEC 17025 accreditation provides formal recognition to laboratories that demonstrate technical competency, and maintains this recognition through periodic evaluations to ensure continued compliance.

By June 2012, the Company had received 510k clearance to market all five of its assays utilizing EIA technology.

Research and Development

The Company is continuously engaged in research and development activities. During the years ended December 31, 2012, 2011 and 2010, $825,518, $607,408, and $481,433, respectively, were expended for research and development. The Company continues to perform research activities to develop new products and services and to improve existing products and services utilizing the Company’s proprietary technology. The Company also continues to evaluate methodologies to enhance its drug screening capabilities. Additional research using the Company’s proprietary technology is being conducted by outside research organizations through government-funded studies.

Employees

As of December 31, 2012, the Company had 132 full-time equivalent employees, 5 of whom are full-time employees in R&D. None of the Company’s employees is subject to a collective bargaining agreement.

Item 1A. Risk Factors

In addition to other information contained in this Form 10-K, the following risk factors should be carefully considered in evaluating Psychemedics Corporation and its business because such factors could have a significant impact on our business, operating results and financial condition. These risk factors could cause actual results to materially differ from those projected in any forward-looking statements.

Companies may develop products that compete with our products and some of these companies may be larger and better capitalized than we are.

Many of our competitors and potential competitors are larger and have greater financial resources than we do and offer a range of products broader than our products. Some of the companies with which we now compete or may compete in the future may develop more extensive research and marketing capabilities and greater technical and personnel resources than we do, and may become better positioned to compete in an evolving industry. Failure to compete successfully could harm our business and prospects.

Increased competition, including price competition, could have a material impact on the Company's net revenues and profitability.

Our business is intensely competitive, both in terms of price and service. Pricing of drug testing services is a significant factor often considered by customers in selecting a drug testing laboratory. As a result of the clinical laboratory industry undergoing significant consolidation, larger clinical laboratory providers are able to increase cost efficiencies afforded by large-scale automated testing. This consolidation results in greater price competition. The Company may be unable to increase cost efficiencies sufficiently, if at all, and as a result, its net earnings and cash flows could be negatively impacted by such price competition. The Company may also face increased competition from companies that do not comply with existing laws or regulations or otherwise disregard compliance standards in the industry. Additionally, the Company may also face changes in fee schedules, competitive bidding for laboratory services or other actions or pressures reducing payment schedules as a result of increased or additional competition. Additional competition, including price competition, could have a material adverse impact on the Company's net revenues and profitability.

Our results of operations are subject in part to variation in our customers' hiring practices and other factors beyond our control.

Our results of operations have been and may continue to be subject to variation in our customers' hiring practices, which in turn is dependent, to a large extent, on the general condition of the economy. Results for a particular quarter may vary due to a number of factors, including:

- economic conditions in our markets in general;
- economic conditions affecting our customers and their particular industries;

- the introduction of new products and product enhancements by us or our competitors; and
- pricing and other competitive conditions.

A failure to obtain and retain new customers, or a loss of existing customers, or a reduction in tests ordered, could impact the Company's ability to successfully grow its business.

The Company needs to obtain and retain new customers. In addition, a reduction in tests ordered, without offsetting growth in its customer base, could impact the Company's ability to successfully grow its business and could have a material adverse impact on the Company's net revenues and profitability. We compete primarily on the basis of the quality of testing, reputation in the industry, the pricing of services and ability to employ qualified personnel. The Company's failure to successfully compete on any of these factors could result in the loss of customers and a reduction in the Company's ability to expand its customer base.

Our business could be harmed if we are unable to protect our technology.

We rely primarily on a combination of trade secrets, patents and trademark laws and confidentiality procedures to protect our technology. Despite these precautions, unauthorized third parties may infringe or copy portions of our technology. In addition, because patent applications in the United States are not publicly disclosed until either (1) 18 months after the application filing date or (2) the publication date of an issued patent wherein applicant(s) seek only US patent protection, applications not yet disclosed may have been filed which relate to our technology. Moreover, there is a risk that foreign intellectual property laws will not protect our intellectual property rights to the same extent as United States intellectual property laws. In the absence of the foregoing protections, we may be vulnerable to competitors who attempt to copy our products, processes or technology.

Our business could be affected by a computer or other IT System failure.

A computer or IT system failure could affect our ability to perform tests, report test results or properly bill customers. Failures could occur as a result of the standardization of our IT systems and other system conversions, telecommunications failures, malicious human acts (such as electronic break-ins or computer viruses) or natural disasters. Sustained system failures or interruption of the Company's systems in one or more of its operations could disrupt the Company's ability to process and provide test results in a timely manner and/or bill the appropriate party. Failure of the Company's information systems could adversely affect the Company's business, profitability and financial condition.

Failure to maintain confidential information could result in a significant financial impact.

The Company maintains confidential information regarding the results of drug tests and other information including credit card and payment information from our customers. The failure to protect this information could result in lawsuits, fines or penalties. Any loss of data or breach of confidentiality, such as through a computer security breach, could expose the Company to a financial liability.

Our future success will depend on the continued services of our key personnel.

The loss of any of our key personnel could harm our business and prospects. We may not be able to attract and retain personnel necessary for the development of our business. We do not have key personnel under contract other than 3 officers who have agreements providing for severance and non compete covenants in the event of termination of employment following a change of control. Further, we do not have any key man life insurance for any of our officers or other key personnel.

There is a risk that our insurance will not be sufficient to protect us from errors and omissions liability or other claims, or that in the future errors and omissions insurance will not be available to us at a reasonable cost, if at all.

Our business involves the risk of claims of errors and omissions and other claims inherent to our business. We maintain errors and omissions and general liability insurance subject to deductibles and exclusions. There is a risk that our insurance will not be sufficient to protect us from all such possible claims. An under-insured or uninsured claim could harm our operating results or financial condition.

Our research and development capabilities may not produce viable new services or products.

In order to remain competitive, we need to continually improve our products, develop new technologies to replace older technologies that have either become obsolete or for which patent protection is no longer available. It is uncertain whether we will continually be able to develop services that are more efficient, effective or that are suitable for our customers. Our ability to create viable products or services depends on many factors, including the implementation of appropriate technologies, the development of effective new research tools, the complexity of the chemistry and biology, the lack of predictability in the scientific process and the performance and decision-making capabilities of our scientists. There is no guarantee that our research and development teams will be successful in developing improvements to our technology.

Improved testing technologies, or the Company's customers using new technologies to perform their own tests, could adversely affect the Company's business.

Advances in technology may lead to the development of more cost-effective technologies such as point-of-care testing equipment that can be operated by third parties or customers themselves in their own offices, without requiring the services of a freestanding laboratory. Development of such technology and its use by the Company's customers could

reduce the demand for its testing services and negatively impact our revenues.

We may not be able to recruit and retain the experienced scientists and management we need to compete in our industry.

Our future success depends upon our ability to attract, retain and motivate highly skilled scientists and management. Our ability to achieve our business strategies depends on our ability to hire and retain high caliber scientists and other qualified experts. We compete with other testing companies, research companies and academic and research institutions to recruit personnel and face significant competition for qualified personnel. We may incur greater costs than anticipated, or may not be successful, in attracting new scientists or management or in retaining or motivating our existing personnel.

Our future success also depends on the personal efforts and abilities of the principal members of our senior management and scientific staff to provide strategic direction, to manage our operations and maintain a cohesive and stable environment.

Our facilities and practices may fail to comply with government regulations.

Our testing facilities and processes must be operated in conformity with current government regulations. These requirements include, among other things, quality control, quality assurance and the maintenance of records and documentation. If we fail to comply with these requirements, we may not be able to continue our services to certain customers, or we could be subject to fines and penalties, suspension of production, or withdrawal of our certifications. We operate a facility that we believe conforms to all applicable requirements. This facility and our testing practices are subject to periodic regulatory inspections to ensure compliance.

Our business could be harmed from the loss or suspension of any licenses.

The forensic laboratory testing industry is subject to significant regulation and many of these statutes and regulations are subject to change. The Company cannot assure that applicable statutes and regulations will not be interpreted or applied by a regulatory authority in a manner that would adversely affect its business. Potential sanctions for violation of these regulations could include the suspension or loss of various licenses, certificates and authorizations, which could have a material adverse effect on the Company’s business.

If our use of chemical and hazardous materials violates applicable laws or regulations or causes personal injury we may be liable for damages.

Our drug testing activities, including the analysis and synthesis of chemicals, involve the controlled use of chemicals, including flammable, combustible, and toxic materials that are potentially hazardous. Our use, storage, handling and disposal of these materials is subject to federal, state and local laws and regulations, including the Resource Conservation and Recovery Act, the Occupational Safety and Health Act and local fire codes, and regulations promulgated by the Department of Transportation, the Drug Enforcement Agency, the Department of Energy, and the California Department of Public Health and Environment. We may incur significant costs to comply with these laws and regulations in the future. In addition, we cannot completely eliminate the risk of accidental contamination or

injury from these materials, which could result in material unanticipated expenses, such as substantial fines or penalties, remediation costs or damages, or the loss of a permit or other authorization to operate or engage in our business. Those expenses could exceed our net worth and limit our ability to raise additional capital.

Our operations could be interrupted by damage to our specialized laboratory facilities.

Our operations are dependent upon the continued use of our highly specialized laboratories and equipment in Culver City, California. Catastrophic events, including earthquakes, fires or explosions, could damage our laboratories, equipment, scientific data, work in progress or inventories of chemicals and may materially interrupt our business. We employ safety precautions in our laboratory activities in order to reduce the likelihood of the occurrence of certain catastrophic events; however, we cannot eliminate the chance that such events will occur. The availability of laboratory space in these locations is limited, and rebuilding our facilities could be time consuming and result in substantial delays in fulfilling our agreements with our customers. We maintain business interruption insurance to cover continuing expenses and lost revenue caused by such occurrences. However, this insurance does not compensate us for the loss of opportunity and potential harm to customer relations that our inability to meet our customers' needs in a timely manner could create.

Agreements we have with our employees, consultants and customers may not afford adequate protection for our trade secrets, confidential information and other proprietary information.

In addition to patent protection, we also rely on copyright and trademark protection, trade secrets, know-how, continuing technological innovation and licensing opportunities. In an effort to maintain the confidentiality and ownership of our trade secrets and proprietary information, we require our employees, consultants and advisors to execute confidentiality and proprietary information agreements. However, these agreements may not provide us with adequate protection against improper use or disclosure of confidential information and there may not be adequate remedies in the event of unauthorized use or disclosure. Furthermore, we may from time to time hire scientific personnel formerly employed by other companies involved in one or more areas similar to the activities we conduct. In some situations, our confidentiality and proprietary information agreements may conflict with, or be subject to, the rights of third parties with whom our employees, consultants or advisors have prior employment or consulting relationships. Although we require our employees and consultants to maintain the confidentiality of all proprietary information of their previous employers, these individuals, or we, may be subject to allegations of trade secret misappropriation or other similar claims as a result of their prior affiliations. Finally, others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets. Our failure or inability to protect our proprietary information and techniques may inhibit or limit our ability to compete effectively, or exclude certain competitors from the market.

Risks Related to Our Stock

Our quarterly operating results could fluctuate significantly, which could cause our stock price to decline.

Our quarterly operating results have fluctuated in the past and are likely to fluctuate in the future. Our results are impacted by the extent to which we are able to gain new customers and on the hiring practices of our existing customers, which are, in turn, impacted by general economic conditions. Entering into new customer contracts can involve a long lead time. Accordingly, negotiation can be lengthy and is subject to a number of significant risks, including customers' budgetary constraints and internal reviews. Due to these and other market factors, our operating results could fluctuate significantly from quarter to quarter. In addition, we may experience significant fluctuations in

quarterly operating results due to factors such as general and industry-specific economic conditions that may affect the budgets and the hiring practices of our customers.

Due to the possibility of fluctuations in our revenue and expenses, we believe that quarter-to-quarter comparisons of our operating results are not necessarily a good indication of our future performance. Our operating results in some quarters may not meet the expectations of stock market analysts and investors. If we do not meet analysts' and/or investors' expectations, our stock price could decline.

Our stock price could experience substantial volatility.

The market price of our common stock has historically experienced and may continue to experience extensive volatility. Our quarterly operating results, the success or failure of future development efforts, changes in general conditions in the economy or the financial markets and other developments affecting our customers, our competitors or us could cause the market price of our common stock to fluctuate substantially. This volatility may adversely affect the price of our common stock. In the past, securities class action litigation has often been instituted following periods of volatility in the market price of a company's securities. A securities class action suit against us could result in potential liabilities, substantial costs and the diversion of management's attention and resources, regardless of whether we win or lose.

Payment of a dividend could decline or cease.

Because we have historically paid dividends, any cessation of our program or reduction in our quarterly dividend could affect our stock price. We have paid dividends on our common stock for 65 consecutive quarters. It is our intent to continue this practice as long as we are able. However, if we are forced to cease this practice or reduce the amount of the regular dividend, due to operating or economic conditions, our stock price could suffer. In December 2008, the Company also paid a special dividend. Investors should not anticipate or expect any future or recurring special dividends. Further, if the Company ceases its future dividends, a return on investment in our common stock would depend entirely upon future appreciation. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

The general economic condition could deteriorate.

Our business is dependent upon new hiring and the supply of new jobs created by overall economic conditions. If the economy deteriorates, leading to a downturn in new job creation, our business and stock price could be adversely affected.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Company maintains its corporate office and northeast sales office at 125 Nagog Park, Acton, Massachusetts; the office consists of 3,971 square feet and is leased through February 2015.

The Company leases 18,000 square feet of space in Culver City, California, for laboratory purposes. This facility is leased through December 31, 2015 with an option to renew for an additional two years. The Company also leases an additional 5,400 square feet of space in Culver City, California for customer service and information technology purposes. This office space is leased through December 31, 2015 with an option to renew for an additional two years.

Item 3. Legal Proceedings

The Company is involved in various suits and claims in the ordinary course of business. The Company does not believe that the disposition of any such suits or claims will have a material adverse effect on the continuing operations or financial condition of the Company.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the NASDAQ Stock Market under the symbol "PMD". As of February 25, 2013, there were 189 record holders of the Company's common stock. The number of record owners was determined from the Company's stockholder records maintained by the Company's transfer agent and does not include beneficial owners of the Company's common stock whose shares are held in the names of various security holders, dealers and clearing agencies. The Company believes that the number of beneficial owners of the Company's common stock held by others as or in nominee names exceeds 2,000.

The following table sets forth for the periods indicated the range of prices for the Company's common stock as reported by the NASDAQ Stock Exchange and dividends declared by the Company.

	High	Low	Dividends
Fiscal 2011:			
First Quarter	$11.09	$7.98	$ 0.120
Second Quarter	11.12	9.00	0.120
Third Quarter	9.84	6.85	0.120
Fourth Quarter	9.34	7.33	0.120
Fiscal 2012:			
First Quarter	$10.40	$9.11	$ 0.150
Second Quarter	10.48	9.46	0.150
Third Quarter	12.19	10.10	0.150
Fourth Quarter	12.49	10.60	0.150

The Company has paid dividends over the past sixteen years. It most recently declared a dividend in February, 2013, which will be paid in March, 2013. The Company's current intention is to continue to declare dividends to the extent funds are available and not required for operating purposes or capital requirements, and only then, upon approval by the Board of Directors.

Issuer Purchases of Equity Securities

During 2012, the Company did not repurchase any common shares for treasury.

Unregistered Sales of Equity Securities and Use of Proceeds

There were no unregistered sales of common stock of the Company during 2012.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2012, with respect to shares of the Company's common stock that were issuable under the Company's 2006 Incentive Plan (the "2006 Incentive Plan").

The table does not include information with respect to shares subject to outstanding options granted under other equity compensation plans that were no longer in effect on December 31, 2012. Footnote (2) to the table sets forth the total number of shares of common stock issuable upon the exercise of options under such expired or discontinued plans as of December 31, 2012, and the weighted average exercise price of those options. No additional options may be granted under such other expired or discontinued plans.

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities That Remained Available for Future Issuance (c)
Equity compensation plans approved by security holders [1] [2]	137,475	$ 0.00	220,069
Equity compensation plans not approved by security holders	—	—	—
Total	137,475	$ 0.00	220,069

(1) Consists of the 2006 Incentive Plan.

(2) This table does not include information for the Company's 2000 Stock Option Plan (discontinued on May 11, 2006). As of December 31, 2012, a total of 199,838 shares of common stock were issuable upon the exercise of outstanding options under the foregoing discontinued plan. The weighted average exercise price of outstanding options under such plan is $13.62 per share. No additional options may be granted under the 2000 Stock Option Plan.

Performance Graph

	2007	2008	2009	2010	2011	2012
Psychemedics Corporation	100.00	46.34	57.33	63.98	73.04	87.02
Russell 2000 Index	100.00	60.91	82.01	103.61	98.02	110.90
NASDAQ Composite Index	100.00	59.46	85.55	100.02	98.22	116.55

Calculated by the Company using *www.yahoo.com/finance* historical prices

(1) The above graph assumes a $100 investment on December 31, 2007, through the end of the 5-year period ended December 31, 2012 in the Company's Common Stock, the Russell 2000 Index and the NASDAQ Composite Index. The prices all assume the reinvestment of dividends.

(2) The Russell 2000 Index is composed of the smallest 2,000 companies in the Russell 3,000 Index. The Company has been unable to identify a peer group of companies that engage in testing of drugs of abuse, except for large pharmaceutical companies where such business is insignificant to such companies' other lines of businesses. The Company therefore uses in its proxy statements a peer index based on market capitalization.

(3) The NASDAQ Composite Index includes companies whose shares are traded on the NASDAQ Stock Exchange Market. In September 2008, Psychemedics moved its listing to the NASDAQ Stock Exchange Market from the AMEX Stock Exchange Market.

Item 6. Selected Financial Data

The selected financial data presented below is derived from our financial statements and should be read in connection with those statements.

	As of and for the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(In Thousands, Except for per Share Data)				
Revenue	$25,224	$24,090	$20,109	$16,955	$22,949
Gross profit	14,252	14,473	12,042	9,610	13,350
Income from operations	4,936	5,800	4,414	2,584	4,707
Net income	2,980	3,489	2,614	1,527	2,969
Basic net income per share	0.57	0.67	0.50	0.29	0.57
Diluted net income per share	0.57	0.67	0.50	0.29	0.57
Total assets	14,212	13,801	11,766	10,602	12,628
Working capital	7,491	9,217	8,566	8,471	9,516
Shareholders' equity	11,223	11,035	9,748	9,294	10,560
Cash dividends declared per common share	0.60	0.48	0.48	0.53	1.16

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Management's Discussion and Analysis of Financial Condition and Results of Operations should be read together with the more detailed business information and financial statements and related notes that appear elsewhere in this annual report on Form 10-K. This annual report may contain certain "forward-looking" information within the meaning of the Private Securities Litigation Reform Act of 1995. This information involves risks and uncertainties. Actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "Item 1A — Risk Factors."

Overview

Psychemedics Corporation is the world's largest provider of hair testing for drugs of abuse, utilizing a patented hair analysis method involving liquefying hair, enzyme immunoassay 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 in the United States and internationally. During the year ended December 31, 2012, the Company generated $25.2 million in revenue, while maintaining a gross margin of 57% and pre-tax margins of 20%. At December 31, 2012, the Company had $3.1 million of cash, and cash equivalents. During 2012, the Company had operating cash flow of $3.6 million and it distributed approximately $3.2 million or $0.60 per share of cash dividends to its shareholders. To date, the Company has paid sixty-five consecutive quarterly cash dividends.

The following table sets forth, for the periods indicated, the selected statements of operations data as a percentage of total revenue:

	Year Ended December 31,		
	2012	2011	2010
Revenue	100.0 %	100.0 %	100.0 %
Cost of revenue	43.5 %	39.9 %	40.1 %
Gross profit	56.5 %	60.1 %	59.9 %
Operating expenses:			
General and administrative	15.6 %	16.4 %	20.9 %
Marketing and selling	18.0 %	17.1 %	14.6 %
Research and development	3.3 %	2.5 %	2.4 %
Total operating expenses	36.9 %	36.0 %	37.9 %
Operating income	19.6 %	24.1 %	22.0 %
Other income			
Interest income	0.0 %	0.0 %	0.1 %
Total other income	0.0 %	0.0 %	0.1 %
Income before taxes	19.6 %	24.1 %	22.1 %
Provision for income taxes	7.8 %	9.6 %	9.1 %
Net income	11.8 %	14.5 %	13.0 %

Results for the Year Ended December 31, 2012 Compared to Results for the Year Ended December 31, 2011

Revenue increased $1.1 million or 5% to $25.2 million in 2012 compared to $24.1 million in 2011. This increase was due to an increase in volume from new and existing clients. Average revenue per sample decreased 3% between 2012 and 2011.

Gross profit decreased $221 thousand to $14.3 million in 2012 compared to $14.5 million in 2011. Direct costs increased by 14% from 2011 to 2012, mainly associated with the cost of labor and materials. The higher costs were driven by the transition in screening technologies as well as from higher volume. The gross profit margin decreased to 57% in 2012 from 60% in 2011.

General and administrative ("G&A") expenses were $3.9 million for the year ended December 31, 2012 and December 31, 2011. As a percentage of revenue, G&A expenses were 15.6% and 16.4% for the years ended December 31, 2012 and 2011, respectively.

Marketing and selling expenses were $4.5 million for the year ended December 31, 2012, compared to $4.1 million for the year ended December 31, 2011, an increase of 10%. Total marketing and selling expenses represented 18.0% and 17.1% of revenue for the years ended December 31, 2012 and 2011, respectively. The increase was driven by an expansion of the sales staff as well as higher information technology costs for marketing and selling projects.

Research and development ("R&D") expenses for 2012 were $0.8 million compared to $0.6 million for 2011. R&D expenses represented 3.3% and 2.5% of revenue for the years ended December 31, 2012 and 2011, respectively. The additional expenses related to the new enzyme immunoassay (EIA) screening process.

Interest income decreased approximately $3,000 to approximately $2,000 for the year ended December 31, 2012 compared to $5,000 for the year ended December 31, 2011. Interest income in both periods represented interest and dividends earned on cash equivalents and short-term investments. A decrease in the yield and a decrease in investment balances in 2012 as compared to 2011 caused the decrease in interest income.

During the year ended December 31, 2012, the Company recorded a tax provision of $2.0 million, representing an effective tax rate of 39.7%. During the year ended December 31, 2011, the Company recorded a tax provision of $2.3 million, representing an effective tax rate of 39.9%. We do not expect a significant change in our tax rate in the foreseeable future.

Results for the Year Ended December 31, 2011 Compared to Results for the Year Ended December 31, 2010

Revenue increased $4.0 million or 20% to $24.1 million in 2011 compared to $20.1 million in 2010. This increase was due to an increase in volume from new and existing clients. Average revenue per sample decreased 1% between 2011 and 2010.

Gross profit increased $2.5 million to $14.5 million in 2011 compared to $12.0 million in 2010. Direct costs increased by 19% from 2010 to 2011, mainly associated with the direct cost of materials resulting from higher volumes. The gross profit margin remained 60% from 2010 to 2011.

General and administrative ("G&A") expenses were $3.9 million for the year ended December 31, 2011 compared to $4.2 million for the year ended December 31, 2010, representing a decrease of 7%. As a percentage of revenue, G&A expenses were 16.4% and 20.9% for the years ended December 31, 2011 and 2010, respectively. This reduction is attributable to the retirement of the VP-General Counsel at the end of 2010.

Marketing and selling expenses were $4.1 million for the year ended December 31, 2011, compared to $2.9 million for the year ended December 31, 2010, an increase of 41%. Total marketing and selling expenses represented 17.1% and 14.6% of revenue for the years ended December 31, 2011 and 2010, respectively. The increase was driven by an expansion of the sales staff as well as higher commissions for new business growth.

Research and development ("R&D") expenses for 2011 were $0.6 million compared to $0.5 million for 2010. R&D expenses represented 2.5% and 2.4% of revenue for the years ended December 31, 2011 and 2010, respectively.

Interest income decreased approximately $18,000 to approximately $5,000 for the year ended December 31, 2011 compared to $23,000 for the year ended December 31, 2010. Interest income in both periods represented interest and

dividends earned on cash equivalents and short-term investments. A decrease in the yield and a decrease in investment balances in 2011 as compared to 2010 caused the decrease in interest income.

During the year ended December 31, 2011, the Company recorded a tax provision of $2.3 million, representing an effective tax rate of 39.9%. During the year ended December 31, 2010, the Company recorded a tax provision of $1.8 million, representing an effective tax rate of 41.1%. We do not expect a significant change in our tax rate in the foreseeable future.

Liquidity and Capital Resources

At December 31, 2012, the Company had $3.1 million of cash and cash equivalents, compared to $5.6 million at December 31, 2011. The Company's operating activities generated net cash of $3.1 million in 2012, $3.9 million in 2011 and $3.3 million in 2010. Investing activities used $2.3 million in 2012, generated $0.5 million in 2011 and used $1.9 million in 2010. Financing activities used $3.3 million in 2012, $2.6 million in 2011 and $2.6 million in 2010.

Operating cash flow of $3.1 million in 2012 primarily reflected net income of $3.0 million adjusted for depreciation and amortization of $0.6 million, stock compensation expense of $0.5 million, an increase in accounts receivable of $0.1 million, a decrease in accounts payable of $0.3 million, a decrease in accrued expenses of $0.4 million, an increase in prepaid expenses (and other current assets) of $0.5 million, and an increase in net deferred tax liabilities of $0.4 million. Operating cash flow of $3.9 million in 2011 primarily reflected net income of $3.5 million adjusted for depreciation and amortization of $0.4 million, stock compensation expense of $0.4 million, an increase in accounts receivable of $0.6 million, an increase in accounts payable of $0.3 million, an increase in prepaid expenses (and other current assets) of $0.4 million, and an increase in net deferred tax liabilities of $0.4 million. Operating cash flow of $3.3 million in 2010 primarily reflected net income of $2.6 million adjusted for depreciation and amortization of $0.3 million, stock compensation expense of $0.4 million, an increase in prepaid expenses and accounts receivable of $0.9 million and an increase in accounts payable of $0.5 million, and an increase in accrued expenses of $0.2 million.

Investing cash flow principally reflected the purchase and sale of short-term investments and capital expenditures. During 2012, there was an increase of $0.1 million in other assets which primarily related to patent costs. During 2011, the Company redeemed at par short-term investments of $2.0 million. Also in 2011, there was an increase of $0.1 million in other assets which primarily related to patent costs. During 2010, the Company invested in short-term investments of $1.0 million. Capital expenditures were $2.2 million, $1.4 million, and $0.08 million in 2012, 2011 and 2010, respectively. The expenditures related principally to new equipment and new software, including laboratory and computer equipment. 2012 had a large increase in capital expenditures primarily due to the implementation of the Company's new EIA technology. The Company does not expect this level of investment to recur in the near future.

During 2012, the Company did not repurchase any shares of common stock for treasury. During 2011, the Company repurchased 2,785 shares of common stock for treasury. The Company has authorized 750,000 shares for repurchase since June of 1998, of which 250,000 shares of common stock were authorized in March of 2008 for repurchase. Since 1998, a total of 550,684 shares have been repurchased. The Company also distributed $3.2 million, $2.5 million, and $2.5 million of cash dividends to its shareholders in 2012, 2011, and 2010 respectively.

At December 31, 2012, the Company's principal sources of liquidity included approximately $3.1 million of cash and cash equivalents. Management currently believes that such funds, together with future operating profits, should be adequate to fund anticipated working capital requirements and capital expenditures in the near term. Depending upon the Company's results of operations, its future capital needs and available marketing opportunities, the Company may use various financing sources to raise additional funds. Such sources could include joint ventures, issuance of common stock or debt financing, although there is no assurance that such financings will be available to the Company on terms it deems acceptable, if at all. At December 31, 2012, the Company had no long-term debt.

The Company has paid dividends over the past sixty-five quarters. It most recently declared a dividend in February 2013 which will be paid in March 2013 in the amount of $790,864. The Company's current intention is to continue to declare dividends to the extent funds are available and not required for operating purposes or capital requirements, and only then, upon approval by the Board of Directors. There can be no assurance that in the future the Company will declare dividends.

Contractual obligations as of December 31, 2012 were as follows:

	Payments Due by Period				
Contractual Obligation	Less Than 1 Year	1 – 3 Years	4 – 5 Years	Greater Than 5 Years	Total
	(Amounts in Thousands)				
Operating leases	$608	$1,171	$ —	$ —	$1,779
Purchase commitment	113	—	—	—	113
Total	$721	$1,171	$ —	$ —	$1,892

Purchase Commitment

The Company has had a supply agreement with a vendor which required the Company to purchase isotopes used in its radioimmunoassay (RIAH) drug testing procedures. Purchases amounted to $609,965, $527,000, and $432,000 in 2012, 2011 and 2010 respectively. The Company expects to purchase $113,000 of isotopes in the first quarter of 2013. As a result of the conversion from RIAH to EIA testing methods, the supply agreement will terminate in March 2013, at which time, all transition activities are expected to be complete.

Significant Customers

The Company did not have any individual customers that exceeded 10% of revenue for the years ended December 31, 2012 and 2011 or accounts receivable as of December 31, 2012 and 2011.

Critical Accounting Policies

The Company's significant accounting policies are described in Note 2 to the financial statements included in Item 8 of this Form 10-K. Management believes the most critical accounting policies are as follows:

Revenue Recognition

The Company is in the business of performing drug testing 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 in accordance with Accounting Standards Codification "ASC" 605, " *Revenue Recognition* ." In accordance with ASC 605, 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.

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 tax valuation, 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.

Capitalized Development Costs

We capitalize costs related to significant software projects developed or obtained for internal use. Costs incurred during the preliminary project work stage or conceptual stage, such as determining the performance requirements, system requirements and data conversion, are expensed as incurred. Costs incurred in the application development phase, such as coding, testing for new software and upgrades that result in additional functionality, are capitalized and are amortized using the straight-line method over the useful life of the software for 5 years. Costs incurred during the post-implementation/operation stage, including training costs and maintenance costs, are expensed as incurred. In accordance with Company policy, during the years ended December 31, 2012 and 2011, we capitalized internally developed software costs of $794,000 and $387,000, respectively. Depreciation expense related to software development costs was $98,301, $8,840, and $0 in 2012, 2011, and 2010, respectively. Determining whether particular costs incurred are more properly attributable to the preliminary or conceptual stage, and thus expensed, or to the application development phase, and thus capitalized and amortized, depends on subjective judgments about the nature of the development work, and our judgments in this regard may differ from those made by other companies. General and administrative costs related to developing or obtaining such software are expensed as incurred.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on management's assessment of the ability to collect amounts owed to it by its customers. Management reviews its accounts receivable aging for doubtful accounts and uses a methodology based on calculating the allowance using a combination of factors including the age of the receivable along with management's judgment to identify 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.

The Company had net deferred tax liabilities in the amount of $605,000 at December 31, 2012, which primarily relate to timing differences.

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 December 31, 2012 or 2011. The Company does not expect the unrecognized tax benefits to change significantly over the next twelve months.

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.

Recent Accounting Pronouncements

There were no new accounting pronouncements issued or effective during the fiscal year which have had or are expected to have a material impact on the Financial Statements. See Note 2 – Accounting Policies , to the Financial Statements for further detail on applicable accounting pronouncements that were adopted in 2012.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not Required.

Item 8. Financial Statements and Supplementary Data

(a) Financial Statements:

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Psychemedics Corporation
Acton, Massachusetts:

We have audited the accompanying balance sheets of the Company as of December 31, 2012 and 2011 and the related statements of income and comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2012 and 2011 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Boston, Massachusetts
March 8, 2013

PSYCHEMEDICS CORPORATION
BALANCE SHEETS

	December 31, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$3,065,785	$5,564,233
Short term investments	—	—
Accounts receivable, net of allowance for doubtful accounts of $121,583 in 2012 and $169,191 in 2011	4,620,768	4,490,976
Prepaid expenses and other current assets	823,274	565,508
Income tax receivable	854,212	564,083
Deferred tax assets	209,877	315,501
Total Current Assets	9,573,916	11,500,301
Property and equipment:		
Computer software	1,210,734	1,622,900
Office furniture and equipment	659,866	2,173,285
Laboratory equipment	6,634,043	8,363,371
Leasehold improvements	92,371	930,099
	8,597,014	13,089,655
Less – accumulated depreciation and amortization	(4,395,605)	(11,026,278)
	4,201,409	2,063,377
Other assets	345,293	237,174
Total Assets	$14,120,618	$13,800,852
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$669,789	$961,844
Accrued expenses	1,413,541	1,321,856
Total Current Liabilities	2,083,330	2,283,700
Deferred tax liabilities, long-term	814,619	482,523
Total Liabilities	2,897,949	2,766,223
Commitments and Contingencies (Note 9)		
Shareholders' Equity:		
Preferred-stock, $0.005 par value, 872,521 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.005 par value; 50,000,000 shares authorized 5,940,558 shares issued in 2012 and 5,903,552 shares issued 2011,		

5,272,428 shares outstanding in 2012 and 5,235,422 shares outstanding in 2011	29,703	29,518
Additional paid-in capital	28,460,764	28,095,946
Less - Treasury stock, at cost, 668,130 shares	(10,081,789)	(10,081,789)
Accumulated deficit	(7,186,009)	(7,009,046)
Total Shareholders' Equity	11,222,669	11,034,629
Total Liabilities and Shareholders' Equity	$ 14,120,618	$ 13,800,852

The accompanying notes are an integral part of these financial statements.

PSYCHEMEDICS CORPORATION
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Year Ended December 31,		
	2012	2011	2010
Revenues	$25,223,534	$24,089,608	$20,108,862
Cost of revenues	10,971,886	9,616,985	8,067,229
Gross profit	14,251,648	14,472,623	12,041,633
Operating Expenses:			
General & administrative	3,946,844	3,948,706	4,195,998
Marketing & selling	4,543,598	4,116,059	2,949,739
Research & development	825,518	607,408	481,433
Total Operating Expenses	9,315,960	8,672,173	7,627,170
Operating income	4,935,688	5,800,450	4,414,463
Interest income	1,889	5,346	23,091
Net income before provision for income taxes	4,937,577	5,805,796	4,437,554
Provision for income taxes	1,957,948	2,316,513	1,823,834
Net income and comprehensive income	$2,979,629	$3,489,283	$2,613,720
Basic net income per share	$0.57	$0.67	$0.50
Diluted net income per share	$0.57	$0.67	$0.50
Dividends declared per share	$0.60	$0.48	$0.48
Weighted average common shares outstanding, basic	5,260,320	5,229,646	5,207,244
Weighted average common shares outstanding, diluted	5,272,542	5,235,940	5,226,454

The accompanying notes are an integral part of these financial statements.

PSYCHEMEDICS CORPORATION
STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock			Treasury Stock			
	Shares	$0.005 par Value	Paid-In Capital	Shares	Cost	Accumulated Deficit	Total
BALANCE, December 31, 2009	5,861,872	$ 29,309	$ 27,419,359	664,523	$ (10,053,364)	$ (8,100,920)	$ 9,294,384
Shares issued – vested	15,486	78	(78)	—	—	—	—
Tax withholding related to vested shares from employee stock plans	—	—	(49,261)	—	—	—	(49,261)
Stock compensation expense	—	—	394,972	—	—	—	394,972
Acquisition of treasury stock	—	—	—	822	(6,034)	—	(6,034)
Cash dividends declared ($0.48 per share)	—	—	—	—	—	(2,500,268)	(2,500,268)
Net income	—	—	—	—	—	2,613,720	2,613,720
BALANCE, December 31, 2010	5,877,358	29,387	27,764,992	665,345	(10,059,398)	(7,987,468)	9,747,513
Shares issued – vested	26,194	131	(131)	—	—	—	—
Tax withholding related to vested shares from employee stock plans	—	—	(86,992)	—	—	—	(86,992)
Stock compensation expense	—	—	418,077	—	—	—	418,077
Acquisition of treasury stock	—	—	—	2,785	(22,391)	—	(22,391)
Cash dividends declared ($0.48 per share)	—	—	—	—	—	(2,510,861)	(2,510,861)
Net income	—	—	—	—	—	3,489,283	3,489,283
BALANCE, December 31, 2011	5,903,552	29,518	28,095,946	668,130	(10,081,789)	(7,009,046)	11,034,629
Shares issued – vested	37,006	185	(185)	—	—	—	—
Tax withholding related to vested shares from employee stock plans	—	—	(93,164)	—	—	—	(93,164)
Stock compensation expense	—	—	458,167	—	—	—	458,167

Cash dividends declared ($0.60 per share)	—	—	—	—	—	(3,156,592)	(3,156,592)
Net income	—	—	—	—	—	2,979,629	2,979,629
BALANCE, December 31, 2012	5,940,558	$ 29,703	$ 28,460,764	668,130	$ (10,081,789)	$ (7,186,009)	$ 11,222,669

The accompanying notes are an integral part of these financial statements.

PSYCHEMEDICS CORPORATION
STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2012	2011	2010
Cash flows from operating activities:			
Net income	$2,979,629	$3,489,283	$2,613,720
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	586,968	370,020	284,911
Deferred income taxes	437,720	406,853	218,154
Stock compensation expense	458,167	418,077	394,972
Changes in operating assets and liabilities:			
Accounts receivable	(129,792)	(585,155)	(889,737)
Prepaid expenses, other current assets and income tax receivable	(547,895)	(428,769)	(37,389)
Accounts payable	(292,055)	262,011	519,049
Accrued expenses	(406,011)	19,486	211,472
Deferred revenue	—	(16,605)	(19,755)
Net cash provided by operating activities	3,086,731	3,935,201	3,295,397
Cash flows from investing activities:			
Maturities of short-term investments	—	2,018,452	—
Purchases of short-term investments	—	—	(1,012,016)
Increase in other long-term assets	(121,375)	(130,874)	(29,737)
Purchases of property and equipment	(2,214,048)	(1,358,790)	(817,960)
Net cash provided by (used in) investing activities	(2,335,423)	528,788	(1,859,713)
Cash flows from financing activities:			
Dividends paid	(3,156,592)	(2,510,861)	(2,500,268)
Tax withholding related to vested shares from employee stock plans	(93,164)	(86,992)	(49,261)
Acquisition of treasury stock	—	(22,391)	(6,034)
Net cash used in financing activities	(3,249,756)	(2,620,244)	(2,555,563)
Net increase (decrease) in cash and cash equivalents	(2,498,448)	1,843,745	(1,119,879)
Cash and cash equivalents, beginning of year	5,564,233	3,720,488	4,840,367
Cash and cash equivalents, end of year	$3,065,785	$5,564,233	$3,720,488
Supplemental disclosures of cash flow information:			
Cash paid for income taxes	$1,715,000	$2,401,957	$2,009,694
Non-cash investing and financing activities:			
Issuance of restricted stock awards	$185	$131	$78
Acquisition of equipment through accrued liabilities	$497,696	$—	$—

The accompanying notes are an integral part of these financial statements.

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PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

1. Nature of Business and Basis of Presentation

Psychemedics Corporation (the "Company") is the world's largest provider of hair testing for drugs of abuse, utilizing a patented hair analysis method involving liquefying hair, enzyme immunoassay 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 in the United States and internationally.

2. Summary of Significant Accounting Policies

Risks and Uncertainties

The Company is subject to a number of risks and uncertainties similar to those of other companies, such as those associated with the continued expansion of the Company's sales and marketing network, technological developments, intellectual property protection, development of markets for new products and services offered by the Company, the economic health of principal customers of the Company, 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.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates, including those related to bad debts and income tax valuation, 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. Changes in estimates are recorded in the period in which they become known.

Cash Equivalents

All highly liquid investments with original maturities of 90 days or less are considered cash equivalents. These consist of cash savings and U.S. government reserve money market accounts at December 31, 2012. While the money market account contains U.S. federal government backed issues, the account itself is not federally insured. As of December 31, 2012, $0.4 million was in U.S. federal government-backed money-market accounts, which is classified as cash

equivalents.

Fair Value Measurements

The Company follows the provisions of Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures* ("ASC 820"), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements and expands disclosures regarding fair value measurements. Fair value is defined under ASC 820 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

In accordance with ASC 820, the Company's financial assets that are measured at fair value on a recurring basis as of December 31, 2012 and 2011are cash equivalents. Cash equivalents are measured using level one inputs. At December 31, 2012 and 2011, the Company had $0.4 million of level one cash equivalents for each period.

Inventory

The Company typically expenses consumables such as chemicals, antibodies and tubes as purchased.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

2. Summary of Significant Accounting Policies – (continued)

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are provided over the estimated useful lives of the assets, using the straight-line method. Repair and maintenance costs are expensed as incurred. The estimated useful lives of the assets are as follows:

Computer software	3 to 5 years
Office furniture and equipment	3 to 7 years
Laboratory equipment	5 to 7 years
Leasehold improvements	Lesser of estimated useful life or lease term

The Company recorded depreciation and amortization related to property and equipment of $573,712, $362,282, and $282,397 in 2012, 2011 and 2010 respectively.

In 2012, in connection with the transition to EIA from RIAH, the Company disposed of $7.2 million of RIAH and other equipment, all of which had been fully depreciated, and as result, had no impact on earnings or net assets.

Capitalized Software Development Costs

We capitalize costs related to significant software projects developed or obtained for internal use. Costs incurred during the preliminary project work stage or conceptual stage, such as determining the performance requirements, system requirements and data conversion, are expensed as incurred. Costs incurred in the application development phase, such as coding, testing for new software and upgrades that result in additional functionality, are capitalized and are amortized using the straight-line method over the useful life of the software for 5 years. Costs incurred during the post-implementation/operation stage, including training costs and maintenance costs, are expensed as incurred. In accordance with Company policy, during the years ended December 31, 2012 and 2011, we capitalized internally developed software costs of $794,000 and $387,000, respectively. Depreciation expense related to software development costs was $98,301, $8,840, and $0 in 2012, 2011, and 2010, respectively. Determining whether particular costs incurred are more properly attributable to the preliminary or conceptual stage, and thus expensed, or to the application development phase, and thus capitalized and amortized, depends on subjective judgments about the nature of the development work, and our judgments in this regard may differ from those made by other companies. General and administrative costs related to developing or obtaining such software are expensed as incurred.

Other Assets

Other assets primarily consist of capitalized legal costs relating to patent applications. The Company amortizes these costs over ten years from the date of grant of the applicable patent. As of December 31, 2012 and 2011, the Company had capitalized legal costs relating to outstanding patent applications of $299,389, and $194,704, respectively. Amortization expense was $13,256, $7,738, and $2,574 in 2012, 2011, and 2010, respectively. The amount of amortization related to patent applications is expected to remain below $20,000 per year for the next five years.

Revenue Recognition

The Company is in the business of performing drug testing services and reporting the results thereof. The Company's services include, drug testing, 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 ASC 605, "*Revenue Recognition*" ("ASC 605"). In accordance with ASC 605, 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.

Research and Development Expenses

The Company charges all research and development expenses to operations as incurred.

Income Taxes

The Company accounts for income taxes using the liability method pursuant to ASC 740, *Income Taxes*. Under this method, the Company recognizes deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year the differences are expected to reverse. The Company evaluates uncertain tax positions annually and considers whether the amounts recorded for income taxes are adequate to address the Company's tax risk profile. The Company analyzes the potential tax liabilities of specific transactions and tax positions based on management's judgment as to the expected outcome.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

2. Summary of Significant Accounting Policies – (continued)

Concentration of Credit Risk and Off-Balance Sheet Risk

The Company has no significant off-balance-sheet risk such as foreign exchange contracts, option contracts, or other foreign hedging arrangements. Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash and cash equivalents, short-term investments and accounts receivable. The Company places its cash and cash equivalents and short-term investments in highly rated institutions. These include money market accounts holding U.S. federal government reserve securities. While the underlying securities are federally issued, the account itself is not insured. Concentration of credit risk with respect to accounts receivable is limited to certain customers to whom the Company makes substantial sales. To reduce risk, 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. The Company does not require collateral.

Significant Customers

The Company did not have any individual customers that exceeded 10% of revenue for the years ended December 31, 2012 and 2011 or accounts receivable as of December 31, 2012 and 2011.

Comprehensive Income

The Company's comprehensive income was the same as its reported net income for the years ended December 31, 2012, 2011 and 2010.

Stock-Based Compensation

The Company accounts for equity awards in accordance with ASC 718, *Compensation — Stock Compensation* ("ASC 718"). ASC 718 requires employee equity awards to be accounted for under the fair value method. Accordingly, share-based compensation is measured at the grant date based on the fair value of the award. It also requires the measurement of compensation cost at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. The Company uses the straight-line method to recognize share-based compensation over the service period of the award, which is generally equal to the vesting period.

Under ASC 718, the Company recorded $458,167, $418,077, and $394,972 of stock compensation expense in the accompanying statements of income for the years ended December 31, 2012, 2011 and 2010, respectively.

Stock compensation expense by income statement account is as follows:

	2012	2011	2010
Cost of revenues	$91,118	$85,731	$83,286
General & administrative	282,375	266,915	258,916
Marketing and selling	81,819	65,431	52,770
Research and development	2,855	—	—
Total stock compensation	$458,167	$418,077	$394,972

See Note 7 for additional information relating to the Company's stock plans.

Basic and Diluted Net Income per Share

Basic net income per share is computed by dividing net income available to common shareholders 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 shares and dilutive common stock equivalents outstanding during the period. The number of dilutive common stock equivalents 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 the unvested portion of stock unit awards ("SUAs").

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

2. Summary of Significant Accounting Policies – (continued)

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

	2012	2011	2010
Weighted average common shares outstanding	5,260,320	5,229,646	5,207,244
Dilutive common equivalent shares	12,222	6,294	19,210
Weighted average common shares outstanding, assuming dilution	5,272,542	5,235,940	5,226,454

For the years ended December 31, 2012, 2011, and 2010, options to purchase 191,597, 264,088, and 298,390 common shares, respectively, were outstanding but not included in the dilutive common equivalent share calculation as their effect would have been anti-dilutive.

Financial Instruments

Financial instruments include cash equivalents and accounts receivable/payable. Estimated fair values of these financial instruments approximate carrying values due to their short-term nature.

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. Substantially all of the Company's revenues and assets are in the United States.

Subsequent Events

The Company evaluated all events and transactions that occurred after December 31, 2012 through the time of filing with the Securities and Exchange Commission of the Company's annual report on Form 10-K for the year ended December 31, 2012. On February 25, 2013, the Company declared a quarterly dividend of $0.15 per share for a total

of $791 thousand, which will be paid on March 21st, 2013 to shareholders of record on March 7th, 2013. On February 28th, 2013, the Company announced an agreement to market TruTouch Technologies' rapid optical alcohol detection and biometric test in the US. Psychemedics will exclusively distribute the TruTouch solutions to targeted organizations within the United States. The Company did not have any other material recognizable subsequent events.

Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income". Both ASU's are effective for annual reporting periods beginning after December 15, 2011. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. In addition, items of other comprehensive income that are reclassified to profit or loss are required to be presented separately on the face of the financial statements. This guidance is intended to increase the prominence of other comprehensive income in financial statements by requiring that such amounts be presented either in a single continuous statement of income and comprehensive income or separately in consecutive statements of income and comprehensive income. ASU 2011-12 defers the changes in ASU 2011-05 that pertain to how, when and where reclassification adjustments are presented. The Company's adoption of these standards is not expected to have a material impact on the financial statements.

3. Accounts Receivable

The Company maintains an allowance for uncollectible accounts receivable based on management's assessment of the collectability of its customer accounts by reviewing customer payment patterns and other relevant factors. The Company reviews the adequacy of the allowance for uncollectible accounts on a quarterly basis and adjusts the balance as determined necessary. The following is a rollforward of the Company's allowance for doubtful accounts:

	2012	2011
Balance, beginning of period	$169,191	$119,295
Provision for (recoveries of) doubtful accounts	(28,866)	49,896
Write-offs (write-backs)	(18,742)	—
Balance, end of period	$121,583	$169,191

PSYCHEMEDICS CORPORATION

NOTES TO FINANCIAL STATEMENTS
December 31, 2012

4. Accrued Expenses

Accrued expenses consist of the following:

	2012	2011
Accrued payroll and employee benefits	$570,405	$979,686
Accrued hair collection expense	113,355	35,676
Accrued audit and tax consulting	110,491	106,945
Accrued payable for equipment purchases	497,696	—
Other accrued expenses	121,594	199,549
Total Accrued Expenses	$1,413,541	$1,321,856

5. Income Taxes

The income tax provision consists of the following:

	2012	2011	2010
Current –			
Federal	$1,196,926	$1,450,941)	$1,261,670
State	323,302	458,719)	344,010
	1,520,228	1,909,660)	1,605,680
Deferred –			
Federal	346,974	370,710)	171,848
State	90,746	36,143)	46,306
	437,720	406,853)	218,154
Income Tax Provision	$1,957,948	$2,316,513)	$1,823,834

A reconciliation of the effective rate with the federal statutory rate is as follows:

	2012	2011	2010
Federal statutory rate	34.0%	34.0%	34.0%
State income taxes, net of federal benefit	5.5 %	5.6 %	5.6 %
Permanent differences	0.1 %	0.1 %	-0.2 %
Stock based compensation	0.0 %	0.2 %	1.7 %
Effective tax rate	39.6%	39.9%	41.1%

The components of the net deferred tax assets included in the accompanying balance sheets are as follows at December 31:

	2012	2011
Deferred tax assets:		
Stock-based compensation	$162,792	$161,807
Allowance for doubtful accounts	47,959	66,900
Accrued expenses	55,401	110,639
	$266,152	$339,346
Deferred tax liabilities:		
Prepaid expenses	$(56,275)	$(23,845)
Excess of tax over book depreciation and amortization	(814,619)	(482,523)
	(870,894)	(506,368)
Net deferred tax liabiliites	$(604,742)	$(167,022)

These amounts are shown on the balance sheets as follows:

Deferred tax asset short-term	$209,877	$315,501
Deferred tax liability long-term	(814,619)	(482,523)
Net deferred tax liabilities	$(604,742)	$(167,022)

ASC 740 contains a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies). 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. The Company considers many factors when evaluating and estimating the Company’s tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

5. Income Taxes – (continued)

The Company adopted these provisions 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 December 31, 2012 and 2011. The tax years ended December 31, 2009 through December 31, 2012 remain subject to examination by all major taxing authorities.

6. Preferred Stock

The Board of Directors has the authority to designate authorized preferred shares in one or more series and to fix the relative rights and preferences without vote or action by the stockholders. The Board of Directors has no present plans to designate or issue any shares of preferred stock.

7. Stock-Based Awards

The 2006 Incentive Plan initially adopted in 2006, and amended and restated in 2011 (the “2006 Incentive Plan”), provides for grants of options with terms of up to ten years, grants of restricted stock or stock unit awards (SUAs), issuances of stock bonuses or grants other stock-based awards, covering up to 500,000 shares of common stock, plus cash based awards, to officers, directors, employees, and consultants. As of December 31, 2012, 220,069 shares remained available for future grant under the 2006 Incentive Plan.

The fair value of the SUAs is 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.

The Company granted 65,000 SUAs on May 22, 2012. The fair value of the SUAs was $9.79 per share, which was the closing price of the Company’s stock on that date. 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 awardee remains continuously employed throughout the vesting period. In addition, 9,619 SUAs were withheld for taxes, in conjunction with the vesting of SUA’s granted in prior years, and consequently, added back to the shares available for future grant.

The Company granted 59,000 SUAs on May 24, 2011. The fair value of the SUAs was $10.03 per share, which was the closing price of the Company's stock on that date. 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 awardee remains continuously employed throughout the vesting period.

The Company granted 94,000 SUAs on April 7, 2010. The fair value of the SUAs was $7.75 per share, which was the closing price of the Company's stock on that date. 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 awardee remains continuously employed throughout the vesting period. Of these 94,000 units, 20,350 were cancelled upon termination of three employees in 2010.

The Company also has stock option plans that have expired or been terminated, but shares can be issued upon exercise of outstanding options that were granted prior to such expiration or termination. No additional grants of options or other stock based awards may be made under such expired or terminated plans. Activity for these plans is included in this footnote. Options granted under the plans consisted of both non-qualified and incentive stock options and were granted in each case at a price that was not less than the fair market value of the common stock at the date of grant. These options generally have contractual lives of ten years and they are all fully exercisable.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

7. Stock-Based Awards – (continued)

A summary of stock option activity for the Company's stock option plans is as follows:

	Number of Shares	Weighted Average Excersise Price per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value[1]
Outstanding, December 31, 2009	336,921	$ 14.80		
Granted	—	—		
Exercised	—	—		
Terminated	(47,550)	19.93		
Outstanding, December 31, 2010	289,371	13.96		
Granted	—	—		
Exercised	—	—		
Terminated	(68,132)	15.06		
Outstanding, December 31, 2011	221,239	13.62		
Granted	—	—		
Exercised	—	—		
Terminated	(21,401)	13.61		
Outstanding, December 31, 2012	199,838	$ 13.62	2.1 years	$ 32,492

(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 December 31, 2012 ($10.75) exceeded the exercise price of any of the underlying options, multiplied by the number of shares subject to each such option.

A summary of stock unit award activity for the Company is as follows:

	Number of Shares	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value[2]
Outstanding & Unvested, December 31, 2009	42,600		
Granted	94,000		

Converted to common stock*	(21,550)		
Terminated	(20,350)		$179,801
Outstanding & Unvested, December 31, 2010	94,700		
Granted	59,000		
Converted to common stock*	(34,600)		
Terminated	—		$355,351
Outstanding & Unvested, December 31, 2011	119,100		
Granted	65,000		
Converted to common stock*	(46,625)		
Terminated	—		$458,211
Outstanding & Unvested, December 31, 2012	137,475	2.8 years	$1,477,856
Available for grant, December 31, 2012	220,069		

(2) The aggregate intrinsic value on this table was calculated based on the closing market price of the Company's stock on December 31, 2012 ($10.75). For value on the converted stock, the price used is the price on the grant date.

* Figure includes 9,619 shares in 2012, 8,406 shares in 2011 and 6,064 shares in 2010 withheld to cover federal income taxes.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

7. Stock-Based Awards – (continued)

As of December 31, 2012, a total of 557,382 shares of common stock were reserved for issuance under the various stock plans. As of December 31, 2012, the unamortized fair value of awards relating to SUAs was $990,031 to be amortized over a weighted average period of approximately 2.8 years.

8. Employee Benefit Plan

The Psychemedics Corporation 401(k) Savings and Retirement Plan (the 401(k) Plan) is a qualified defined contribution plan in accordance with Section 401(k) of the Internal Revenue Code. All employees over the age of 21 are eligible to make pre-tax contributions up to a specified percentage of their compensation. Under the 401(k) Plan, the Company may, but is not obligated to, match a portion of the employees' contributions up to a defined maximum. Matching contributions of $147,360, $122,961, and $0 were made in the years ended December 31, 2012, 2011 and 2010, respectively.

9. Commitments and Contingencies

Commitments

The Company leases certain of its facilities and equipment under operating lease agreements expiring on various dates through April 2016. Total minimum lease payments, including scheduled increases, are charged to operations on the straight-line basis over the life of the respective lease. Rent expense was approximately $555,129, $548,000 and $558,000 in 2012, 2011 and 2010, respectively.

At December 31, 2012, minimum commitments remaining under lease agreements were approximately as follows:

	Amount
Years Ending December 31:	
2013	$608,000
2014	603,000
2015	546,000
2016	22,000
	$1,779,000

Purchase Commitment

The Company has had a supply agreement with a vendor which required the Company to purchase isotopes used in its radioimmunoassay (RIAH) drug testing procedures. Purchases amounted to $609,965, $527,000, and $432,000 in 2012, 2011 and 2010 respectively. The Company expects to purchase $113,000 of isotopes in the first quarter of 2013. As a result of the conversion from RIAH to EIA testing methods, the supply agreement will terminate in March 2013, at which time, all transition activities are expected to be complete.

Contingencies

The Company is subject to legal proceedings and claims, which arise in the ordinary course of its business. The Company believes that although there can be no assurance as to the disposition of these proceedings, 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.

PSYCHEMEDICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

10. Selected Quarterly Financial Data (Unaudited)

The following are selected quarterly financial data for the years ended December 31, 2012 and 2011:

	Quarter Ended (000's Except Share Amounts)			
	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
Revenues	$6,244	$ 6,862	$ 6,460	$ 5,658
Gross profit	3,665	4,103	3,718	2,766
Income from operations	1,377	1,664	1,431	464
Net income and comprehensive income	827	1,001	879	273
Basic net income per share	0.16	0.19	0.17	0.05
Diluted net income per share	0.16	0.19	0.17	0.05

	Quarter Ended (000's Except Share Amounts)			
	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
Revenues	$6,000	$ 6,228	$ 6,315	$ 5,547
Gross profit	3,617	3,739	3,944	3,173
Income from operations	1,490	1,758	1,808	746
Net income and comprehensive income	858	1,093	1,099	438
Basic net income per share	0.16	0.21	0.21	0.08
Diluted net income per share	0.16	0.21	0.21	0.08

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to ensure that information required to be disclosed in reports filed with the SEC are recorded, processed, summarized and reported within the time period specified by the SEC's rules and forms and that such information is accumulated and communicated to our management, including to our Chief Executive Officer and our Vice President - Finance, as appropriate, to allow for timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, the Company's management, with the participation of the Company's Chief Executive Officer and its Vice President - Finance, has evaluated the effectiveness of its disclosure controls and procedures as of December 31, 2012. Based on this evaluation, our Chief Executive Officer and Vice President - Finance concluded 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 financial officers, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Under the supervision and with the participation of management, including our Chief Executive Officer and Vice President - Finance, the Company conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under the framework in *Internal Control — Integrated Framework* , the Company's management concluded that our internal control over financial reporting was effective as of December

31, 2012.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.

Inherent Limitations on Effectiveness of Controls

The Company's management, including its Chief Executive Officer and its Vice President - Finance, does not expect that the Company's disclosure controls and procedures or the Company's internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives for the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, misstatements, errors and instances of fraud, if any, within our company have been or will be prevented or detected. Further, internal controls may become inadequate as a result of changes in conditions, or through the deteriorations of the degree of compliance with policies or procedures.

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Following is a list that sets forth as of March 8, 2013 the names, ages and positions within the Company of all of the Executive Officers of the Company and the Directors of the Company. Each such director has been nominated for reelection at the Company's 2013 Annual Meeting, to be held on May 23, 2013 at 2:00 P.M. at the Liberty Hotel, 215 Charles Street, Boston, Massachusetts.

Name	Age	Position
Raymond C. Kubacki	68	Chairman, Chief Executive Officer, President, Director
Neil Lerner	45	Vice President- Finance
James Dyke	48	Corporate Vice President, Sales & Marketing
Michael I. Schaffer, Ph.D.	68	Vice President, Laboratory Operations
Harry Connick	87	Director, Audit Committee member, Compensation Committee Member, Nominating Committee member
Walter S. Tomenson, Jr.	66	Director, Audit Committee member, Compensation Committee Member, Nominating Committee member
Fred J. Weinert	65	Director, Audit Committee member, Compensation Committee Member, Nominating Committee member

All Directors hold office until the next annual meeting of stockholders or until their successors are elected. Officers serve at the discretion of the Board of Directors.

Mr. Kubacki has been the Company's President and Chief Executive Officer since 1991. He has also served as Chairman of the Board of the Company since 2003. He is a director of Integrated Environmental Technologies, LTD. From 2007 until 2012, he served as a director of Protection One, Inc. and from 2004 to 2007 he served as a director of Integrated Alarm Services Group, Inc. He is also a trustee of the Center for Excellence in Education based in Washington, D.C. and holds a Masters Professional Director Certification from the American College of Directors. Mr. Kubacki has been a director of the Company since 1991.

Mr. Lerner has served as Vice President Finance and Treasurer since May 2011. From October 2010 until May 2011, he served as Vice President, Controller. Prior to joining the Company, he served as Director of Operational Accounting at Beacon Roofing Supply, Inc., Corporate Controller with Atlas TMS, Divisional Controller with Mastec, Inc, and multiple roles with Johnson & Johnson, including plant controller in the Netherlands. Mr. Lerner is a Certified Public Accountant and has a masters degree in International Management.

Mr. Dyke joined the Company as Corporate Vice President, Sales and Marketing in 2010. Prior to joining the Company, he worked as a Strategic Sales Consultant and held a variety of Vice President of Sales/Sales & Marketing and General Management positions with Pitney Bowes Inc. in Canada, the United Kingdom and United States.

Dr. Schaffer has served as Vice President of Laboratory Operations since 1999. From 1990 to 1999, he served as Director of Toxicology, Technical Manager and Responsible Person for the Leesburg, Florida laboratory of SmithKline Beecham Clinical Laboratories. From 1990 to 1999, he was also a member of the Board of Directors of

the American Board of Forensic Toxicologists. Dr. Schaffer has been an inspector for the Substance Abuse and Mental Health Services Administration’s National Laboratory Certification Program since 1989.

Mr. Connick served as District Attorney for Orleans Parish (New Orleans, LA) from 1974 to 2003. In 2002, Mr. Connick received from Drug Czar, John P. Walters, the Director's Award for Distinguished Service in recognition of exemplary accomplishment and distinguished service in the fight against illegal drugs. Mr. Connick has been a director of the Company since 2003.

Mr. Tomenson is a Senior Advisor to Integro Ltd. Mr. Tomenson was Managing Director and Chairman of Client Development of Marsh, Inc. from 1998 until 2004. From 1993 to 1998, he was chairman of FINPRO, the financial services division of Marsh, Inc. Mr. Tomenson is a Director of the Trinity College School Fund, Inc. He also serves on the Executive Council of the Inner-City Scholarship Fund and holds a Master Professional Director Certification from the American College of Directors. Mr. Tomenson has been a director of the Company since 1999.

Mr. Weinert is an entrepreneur whose current activities are concentrated in commercial real estate, new business development and environmental consulting. He has served on the Business Advisory Council for the University of Dayton for over 20 years. From 1973 until 1989, Mr. Weinert held various executive positions in the Finance and Operations groups of Waste Management, Inc. and its subsidiaries, including 6 years as the President of Waste Management International, Inc. Mr. Weinert has been a director of the Company since 1991.

The information required by Item 405 of Regulation S-K will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

The Company has a code of ethics that applies to all employees and non-employee directors. This code satisfies the requirements set forth in Item 406 of Regulation S-K and applies to all relevant persons set forth therein. The Company will mail to interested parties a copy of the Code of Ethics upon written request and without charge. Such request shall be made to our General Counsel, 125 Nagog Park, Acton, Massachusetts 01720.

The information required by Item 407 of Regulation S-K will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this item will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item will be set forth in the Proxy Statement of the Company relating to the 2013 Annual Meeting of Stockholders to be held on May 23, 2013 and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) (1) Financial Statements required by Item 15 are included and indexed in Part II, Item 8

(a) (2) Financial Statement Schedules included in Part IV of this report. Schedule II is omitted because information is included in Notes to Financial Statements. All other schedules under the accounting regulations of the SEC are not required under the related instructions and are inapplicable and, thus have been omitted.

(a) (3) See “Exhibit Index” included elsewhere in this Report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: March 8, 2013 By:

/s/ Raymond C. Kubacki
Raymond C. Kubacki
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below appoints jointly and severally, Raymond C. Kubacki and Neil Lerner and each one of them, his attorneys-in-fact, each with the power of substitution for him in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the SEC, hereby ratifying and confirming all that each attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

/s/ Raymond C. Kubacki Raymond C. Kubacki	Chairman, President and Chief Executive Officer, Director (Principal Executive Officer)	March 8, 2013
/s/ Neil Lerner Neil Lerner	Vice President- Finance (Principal Financial and Accounting Officer)	March 8, 2013
/s/ Harry Connick Harry Connick	Director	March 8, 2013
/s/ Walter S. Tomenson, Jr. Walter S. Tomenson, Jr.	Director	March 8, 2013

/s/ Fred J. Weinert
Fred J. Weinert

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation filed on August 1, 2002 — (Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2002).
3.2	By-Laws of the Company — (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
4.1	Specimen Stock Certificate — (Incorporated by reference from the Registrant's Registration Statement on Form 8-A filed on July 31, 2002).
10.2.1	Lease dated October 6, 1992 with Mitchell H. Hersch, et. al with respect to premises in Culver City, California — (Incorporated by reference from the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 1992).
10.2.2	Security Agreement dated October 6, 1992 with Mitchell H. Hersch et. al — (Incorporated by reference from the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 1992).
10.2.3	First Amendment to Lease dated with Mitchell H. Hersch, et.al California — (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
10.2.4	Second Amendment to Lease dated with Mitchell H. Hersch, et.al. California — (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
10.2.5	Third Amendment to Lease dated December 31, 1997 with Mitchell H. Hersch, et.al. California — (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
10.2.6	Fourth Amendment to Lease dated May 24, 2005 with Mitchell H. Hersch, et.al. California — (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2005).
10.2.7	Fifth Amendment to Lease dated November 22, 2011 with Mitchell H. Hersch, et.al. California
10.3*	2000 Stock Option Plan, — (Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2002).
10.4*	Amended and restated change in Control Severance Agreement with Raymond C. Kubacki dated July 10, 2008 — (Incorporated by reference from the Registrant's current report on form 8-k, filed on July 14, 2008.)
10.5*	2006 Incentive Plan, as amended — (Incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2011).

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Exhibit Number	Description
10.6*	Form of Stock Unit Award used with employees and consultants under the 2006 Incentive Plan — (Incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2011).
10.7*	Form of Stock Unit Award used with non-employee directors under the 2006 Equity Incentive Plan — (Incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2011).
10.8*	Change in control severance agreement with Michael Schaffer PhD dated July 10, 2008 (Incorporated by reference from the registrant's current report on Form 8-k filed on July 14, 2008)
10.9*	Amendment dated November 3, 2008 to change in control severance agreement with Ray Kubacki. (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2008).
10.10*	Amendment dated November 3, 2008 to change in control severance agreement with Michael Schaffer. (Incorporated by reference from the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2008).
10.11*	Employment offer letter dated April 7, 2010 with James Dyke (incorporated by reference from Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010)
10.12*	Change in Control Severance Agreement with James V Dyke dated April 7,2010 (Incorporated by reference from Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010)
10.13*	Employment offer letter dated October 25, 2010 with Neil Lerner (incorporated by reference from Registrant's Quarterly Report on Form 10-Q for the year ended December 31, 2010)
23.1	Consent of BDO USA, LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Vice President - Finance 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 Vice President - Finance Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management compensation plan or arrangement