PSYCHEMEDICS CORP
Form 10-Q
May 10, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2012

or

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

Commission file number: 1-13738

PSYCHEMEDICS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware	58-1701987
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

125 Nagog Park	
Acton, MA	01720
(Address of Principal Executive Offices)	(Zip Code)

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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 (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

The number of shares of Common Stock of the Registrant, par value $0.005 per share, outstanding at May 8, 2012 was 5,259,527.

PSYCHEMEDICS CORPORATION

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2012

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PSYCHEMEDICS CORPORATION

CONDENSED BALANCE SHEETS

(UNAUDITED)

	March 31, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$4,725,808	$5,564,233
Accounts receivable, net of allowance for doubtful accounts of $150,974 in 2012 and $169,191 in 2011	4,799,119	4,490,976
Prepaid expenses and other current assets	692,937	565,508
Income tax receivable	52,136	564,083
Deferred tax assets	361,424	315,501
Total Current Assets	10,631,424	11,500,301
Fixed Assets:		
Equipment & leasehold improvements	13,287,885	13,089,655
Less accumulated depreciation	(11,160,563)	(11,026,278)
Net Fixed Assets	2,127,322	2,063,377
Other assets	256,213	237,174
Total Assets	$13,014,959	$13,800,852
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$600,257	$961,844
Accrued expenses	741,703	1,321,856
Total Current Liabilities	1,341,960	2,283,700
Deferred tax liabilities, long-term	482,523	482,523
Total Liabilities	1,824,483	2,766,223
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 5,903,552 shares issued in 2012 and 2011	29,518	29,518
Additional paid-in capital	28,209,615	28,095,946
Accumulated deficit	(6,966,868)	(7,009,046)
Less - Treasury stock, at cost, 668,130 shares in 2012 and 2011	(10,081,789)	(10,081,789)
Total Shareholders' Equity	11,190,476	11,034,629
Total Liabilities and Shareholders' Equity	$13,014,959	$13,800,852

See accompanying notes to condensed financial statements

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PSYCHEMEDICS CORPORATION

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended March 31, 2012	2011
Revenues	$6,243,855	$5,999,739
Cost of revenues	2,578,735	2,383,026
Gross profit	3,665,120	3,616,713
Operating Expenses:		
General & administrative	995,441	970,064
Marketing & selling	1,124,825	1,014,117
Research & development	168,048	142,451
Total Operating Expenses	2,288,314	2,126,632
Operating income	1,376,806	1,490,081
Interest income	510	2,205
Net income before provision for income taxes	1,377,316	1,492,286
Provision for income taxes	549,825	633,798
Net income and comprehensive income	$827,491	$858,488
Basic net income per share	$0.16	$0.16
Diluted net income per share	$0.16	$0.16
Dividends declared per share	$0.15	$0.12
Weighted average common shares outstanding, basic	5,235,422	5,212,013
Weighted average common shares outstanding, diluted	5,244,042	5,242,518

See accompanying notes to condensed financial statements

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PSYCHEMEDICS CORPORATION

CONDENSED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$827,491	$858,488
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	137,062	84,522
Stock-based compensation	113,669	95,039
Deferred income taxes	(45,923)	(38,015)
Changes in assets and liabilities		
Accounts receivable	(308,143)	(589,845)
Prepaid expenses, other current assets, and income tax receivable	384,518	(221,484)
Accounts payable	(361,587)	(235,841)
Accrued expenses	(580,153)	(39,882)
Deferred revenue	-	(3,233)
Net cash provided by (used in) operating activities	166,934	(90,251)
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchases of short-term investments	-	(9,125,863)
Sales of short-term investments	-	9,124,965
Purchases of equipment and leasehold improvements	(198,230)	(228,230)
Other assets	(21,816)	(56,489)
Net cash used in investing activities	(220,046)	(285,617)
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Cash dividends paid	(785,313)	(625,441)
Net cash used in financing activities	(785,313)	(625,441)
Net decrease in cash	(838,425)	(1,001,309)
Cash and Cash Equivalents, beginning of period	5,564,233	3,720,488
Cash and Cash Equivalents, end of period	$4,725,808	$2,719,179
Supplemental Disclosures of Cash Flow Information:		
Cash paid for income taxes	$83,800	$450,000

See accompanying notes to condensed financial statements

PSYCHEMEDICS CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

1. Interim Financial Statements

The accompanying unaudited interim financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. Accordingly, certain information and footnote disclosure required for complete financial statements are not included herein. It is recommended that these financial statements be read in conjunction with the financial statements and related notes of Psychemedics Corporation (“the Company,” “our Company,” “our” or “we”) as reported in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, filed on March 9, 2012. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of financial position, results of operations, and cash flows at the dates and for the periods presented have been included. The results of operations for the three months ended March 31, 2012 may not be indicative of the results that may be expected for the year ending December 31, 2012, or any other period.

2. Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of 90 days or less to be cash equivalents. Cash equivalents consist of cash savings and a bank money market account.

3. Stock-Based Compensation

<u>2006 Equity Incentive Plan</u>

The Company’s 2006 Incentive Plan provides for the grant or issuance to officers, directors, employees and consultants of options with terms of up to ten years, restricted stock, stock unit awards (SUA’s), issuances of stock bonuses or other stock-based awards, covering up to 500,000 shares of common stock. As of March 31, 2012, 275,450 shares remained available for future grant under the 2006 Incentive Plan.

The SUAs vest over a period of two years for non-employee board members and four years for employees and are convertible into an equivalent number of shares of the Company's common stock provided that the director or 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 SUAs. Employees are issued shares upon vesting, net of tax withholdings, unless the employee chooses to receive all shares and pay for the associated employment taxes. No other types of equity-based awards have been granted or issued under the 2006 Incentive Plan.

A summary of activity for SUAs under the Company's 2006 Incentive Plan for the three months ended March 31, 2012 is as follows:

	Number of Shares	Aggregate Intrinsic Value (1) (000s)
Unvested, December 31, 2011	119,100	
Granted	-	
Forfeited/expired	-	
Converted to common stock	-	
Unvested, March 31, 2012	119,100	$ 1,170
Available for grant, March 31, 2012	275,450	

(1) The aggregate intrinsic value on this table was calculated based on the closing market value of the Company's stock on March 31, 2012 ($9.82).

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PSYCHEMEDICS CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

3. Stock-Based Compensation (continued)

Expired Plans

As of March 31, 2012, the Company also had outstanding an aggregate of 216,089 options to acquire common stock under plans that had previously expired. A summary of stock option activity for the Company's expired stock option plans for the three months ended March 31, 2012 is as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (2) (000s)
Outstanding, December 31, 2011	221,239	$ 13.62		
Granted	-	-		
Exercised	-	-		
Terminated/Expired	(5,150)	$ 13.60		
Outstanding, March 31, 2012	216,089	$ 13.62	2.7 years	$ 19
Exercisable, March 31, 2012	216,089	$ 13.62	2.7 years	$ 19
Available for grant, March 31, 2012	-			

(2) The aggregate intrinsic value on this table was calculated based on the amount, if any, by which the closing market value of the Company's stock on the March 31, 2012 ($9.82) exceeded the exercise price of the underlying options, multiplied by the number of shares subject to each option.

All Stock-Based Compensation Plans

As of March 31, 2012, a total of 610,639 shares of common stock were reserved for issuance under the various stock option and stock-based plans. As of March 31, 2012, the unamortized fair value of awards relating to outstanding SUAs and options was $698 thousand, which is expected to be amortized over a weighted average period of 2.7 years.

4. Basic and Diluted Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common equivalent shares outstanding during the period. The number of dilutive common equivalent shares outstanding during the period has been determined in accordance with the treasury-stock method. Common equivalent shares consist of common stock issuable upon the exercise of outstanding options and common stock issuable upon the vesting of outstanding, unvested SUAs.

PSYCHEMEDICS CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

	Three Months Ended	
	March 31, 2012	March 31, 2011
	(in thousands)	
Weighted average common shares	5,235	5,212
Common equivalent shares	9	31
Weighted average common shares outstanding, assuming dilution	5,244	5,243

For the three months ended March 31, 2012 and 2011, options to purchase 205 thousand and 278 thousand common shares, respectively, were outstanding but not included in the diluted weighted average common share calculation as the effect would have been antidilutive.

5. Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosures*, provides guidance for using fair value to measure assets and liabilities. It also responds to investors' requests for expanded information about the extent to which companies' measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. ASC 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances.

PSYCHEMEDICS CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

- **Level 1** inputs are unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.
- **Level 2** inputs are quoted prices for similar assets and liabilities in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- **Level 3** inputs are prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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

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

6. Subsequent Events

The Company evaluated all events or transactions that occurred after March 31, 2012 up through the time of filing with the SEC our Quarterly Report on Form 10-Q for the period ended March 31, 2012. During this period, the Company did not have any material recognizable subsequent events, except as disclosed herein.

On May 8, 2012, the Company declared a quarterly dividend of $0.15 per share for a total of $789 thousand, which will be paid on May 31, 2012 to shareholders of record on May 18, 2012.

7. Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) 2011-5, “Comprehensive income” and ASU 2011-12, “Comprehensive Income” - amends existing guidance by allowing only two options for presenting the components of net income and other comprehensive income: (1) in a single continuous statement of comprehensive income or (2) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of other comprehensive income. Also, items that are reclassified from other comprehensive income to net income must be presented on the face of the financial statements. In December 2011, a new accounting standard was issued that indefinitely deferred the effective date for the requirement to present the reclassification of items from comprehensive income on the face of the financial statements. Both standards require retrospective application, and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company adopted the revised accounting standards effective January 1, 2012. The adoption had no impact on the Company's financial position or results of operations, except the expanded disclosures on the face of the Company’s income statement.

8. Commitments and Contingencies

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

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FACTORS THAT MAY AFFECT FUTURE RESULTS

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

OVERVIEW

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

Revenues for the first quarter of 2012 were $6.2 million, an increase of 4% from first quarter 2011 revenue of $6.0 million. The Company reported net income of $0.16 per diluted share for the three months ended March 31, 2012 and March 31, 2011. At March 31, 2012, the Company had $4.7 million of cash and cash equivalents. The Company distributed $785 thousand or $0.15 per share of cash dividends to its shareholders in the three months ended March 31, 2012. The Company has paid sixty-two consecutive quarterly cash dividends.

RESULTS OF OPERATIONS

Revenues were $6.2 million for three months ended March 31, 2012 compared to revenues of $6.0 million for the three months ended March 31, 2011, representing an increase of 4%. The increase in revenues for the three months ended March 31, 2012 was a result of an increase in testing volume from new clients, while our base business experienced a moderate reduction in volume. The amount of average revenue per sample remained about the same.

Gross profit increased $0.1 million to $3.7 million for the three months ended March 31, 2012, compared to $3.6 million for the three months ended March 31, 2011. Direct costs grew by $196 thousand or 8% for the three months ended March 31, 2012 compared to the same period in 2011, mainly due to a greater volume of samples as well as a higher cost of supplies. The gross profit margin decreased to 59% for the three months ended March 31, 2012 compared to 60% for the comparable period of 2011, mainly as a result of an increase in supplies costs.

General and administrative ("G&A") expenses were $995 thousand and $970 thousand for the three months ended March 31, 2012 and 2011, respectively. As a percentage of revenue, G&A expenses were 16% for the three months ended March 31, 2012 and 2011.

Marketing and selling expenses were $1.1 million for the three months ended March 31, 2012 as compared to $1.0 million for the three months ended March 31, 2011, an increase of 10%. Total marketing and selling expenses represented 18% of revenue for the three months ended March 31, 2012, compared to 17% for the comparable period of 2011. The increase in marketing and selling expenses was primarily from higher information technology costs associated with sales and marketing programs.

Research and development ("R&D") expenses for the three months ended March 31, 2012 were $168 thousand compared to $142 thousand for the comparable period of 2011, an increase of 18%. R&D expenses represented 3% of revenue in the first quarter 2012 and 2% for the comparable period of 2011.

Interest income for the three months ended March 31, 2012 decreased by $1 thousand to $1 thousand when compared to the same period of 2011 in which interest income was $2 thousand. Interest income represented interest and dividends earned on cash and cash equivalents. Lower interest rates on our mix of cash and cash equivalents caused the decrease in interest income for the three month period ended March 31, 2012.

Provision for income taxes During the three months ended March 31, 2012 and 2011, the Company recorded income tax provisions of $550 thousand and $634 thousand, respectively. These provisions represented effective tax rates of 40% for the three months ended March 31, 2012 and 42% for the comparable period of 2011. The Company continues to monitor the effective tax rate, but does not expect a significant change for the remaining nine months of 2012.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2012, the Company had approximately $4.7 million of cash and cash equivalents. The Company's operating activities provided net cash of $167 thousand for the three months ended March 31, 2012. Investing activities used $220 thousand of cash while financing activities used $785 thousand of cash during the first three months of 2012.

Cash provided by operating activities of $167 thousand reflected net income of $827 thousand adjusted for depreciation and amortization of $137 thousand, stock-based compensation of $114 thousand and a decrease in prepaid expenses and other current assets of $385 thousand. This was offset by an increase in accounts receivable of $308 thousand, a decrease in accounts payable of $362 thousand, a decrease of accrued expenses of $580 thousand, and an increase of deferred income taxes of $46 thousand. Cash used in investing activities included equipment and leasehold improvements of $198 thousand which were purchased during the first quarter of 2012. We anticipate spending $1.3 million to $1.5 million in additional capital purchases for the remainder of 2012.

During the three months ended March 31, 2012, the Company distributed $785 thousand in cash dividends to its shareholders.

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

	Less Than One Year	1-3 Years	4-5 years	After 5 Years	Total
	(in thousands)				
Operating leases	$599	$1,621	$ 2	$ -	$2,222
Purchase commitment	457	-	-	-	457
	$1,056	$1,621	$ 2	$ -	$2,679

In May 2012, the company extended the lease in its Las Vegas facility for four years, to expire in April 2016. This commitment is reflected in the table above. The Company has a supply agreement with a vendor which requires the Company to purchase isotopes used in its drug testing procedures from this sole supplier in exchange for variable annual payments based upon prior year purchases. Purchases amounted to $153 thousand for the three months ended March 31, 2012 as compared to $132 thousand for the comparable period of 2011. The Company expects to purchase approximately $457 thousand for the remainder of 2012. In exchange for exclusivity, among other things, the supplier has provided the Company with the right to purchase the isotope technology at fair market value under certain conditions, including the failure to meet the Company’s purchase commitments. This agreement does not include a fixed termination date; however, it is cancelable upon mutual agreement by the parties or six months after termination notice by the Company of its intent to use a different technology in connection with its drug testing procedures.

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At March 31, 2012, the Company's principal sources of liquidity included an aggregate of approximately $4.7 million of cash and cash equivalents. Management currently believes that such funds, together with cash generated from operations, should be adequate to fund anticipated working capital requirements and capital expenditures for the next 12 months. Depending upon the Company's results of operations and capital needs, the Company may use various financing sources to raise additional funds, although the Company does not have any such plans at this time. At March 31, 2012, the Company had no long-term debt.

CRITICAL ACCOUNTING POLICIES

Management believes the most critical accounting policies are as follows:

Revenue Recognition

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

The Company recognizes revenue under 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 taxes, and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Allowance for Doubtful Accounts

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

Income Taxes

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

In July 2006, the Financial Accounting Standards Board ("FASB") issued ASC 740*, Income Taxes*. 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. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. The Company adopted the provisions of ASC 740, 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 March 31, 2012 or December 31, 2011.

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

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

Item 4. Controls and Procedures

As of the date of this report, our Chief Executive Officer and our Vice President - Finance performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and 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 disclosed within the time periods specified in the SEC's rules and forms, and that its disclosure controls and procedures were also effective to ensure that information required to be disclosed in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the Company's principal executive and principal financial officers, to allow timely decisions regarding required disclosure. There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect these internal controls over financial reporting subsequent to the date of the most recent evaluation.

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2011 Annual Report on Form 10-K.

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

There were no purchases of treasury stock in the first quarter of 2012.

Item 6. Exhibits

See Exhibit Index included in this Report

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SIGNATURES

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

Psychemedics Corporation

Date: May 10, 2012 By: /s/ Raymond C. Kubacki
Raymond C. Kubacki
Chairman and Chief Executive Officer
(principal executive officer)

Date: May 10, 2012 By: /s/ Neil L. Lerner
Neil L. Lerner
Vice President - Finance
(principal accounting officer)

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PSYCHEMEDICS CORPORATION

FORM 10-Q

March 31, 2012

EXHIBIT INDEX