

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

FORM 10-Q

Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2023
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 (State or Other Jurisdiction of Incorporation or Organization) | 58-1701987 (I.R.S. Employer Identification No.) |
| 289 Great Road Acton, MA (Address of Principal Executive Offices) | 01720 (Zip Code) |

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

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

| | | |
|--|---------------------------------|---|
| <u>Title of Class</u> Common stock. \$0.005 par value | <u>Trading Symbol(s)</u> PMD | <u>Name of each exchange on which registered</u> The Nasdaq Stock Market, LLC. |
|--|---------------------------------|---|

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer
Accelerated filer
Non-accelerated filer
Smaller reporting company
Emerging growth company

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

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

The number of shares of Common Stock of the Registrant, par value \$0.005 per share, outstanding at November 6, 2023, was 5,801,761.

PSYCHEMEDICS CORPORATION
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2023

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

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

| | September 30, 2023 | December 31, 2022 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 1,370 | \$ 4,750 |
| Accounts receivable, net of allowance for doubtful accounts of \$ 38 at September 30, 2023, and \$ 87 at December 31, 2022 | 4,596 | 3,739 |
| Prepaid expenses and other current assets | 1,524 | 1,136 |
| Income tax receivable | 382 | 339 |
| Total Current Assets | 7,872 | 9,964 |
| Fixed assets, net of accumulated amortization and depreciation of \$ 23,312 at September 30, 2023, and \$21,964 at December 31, 2022 | 3,357 | 4,573 |
| Other assets | 809 | 823 |
| Net deferred tax assets | - | 691 |
| Operating lease right-of-use assets | 2,066 | 2,681 |
| Total Assets | \$ 14,104 | \$ 18,732 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 817 | \$ 448 |
| Accrued expenses | 3,208 | 3,939 |
| Current portion of long-term debt | 302 | 294 |
| Current portion of operating lease liabilities | 1,058 | 1,037 |
| Total Current Liabilities | 5,385 | 5,718 |
| Long-term debt | 77 | 305 |
| Deferred tax liabilities, long-term | 7 | - |
| Long-term portion of operating lease liabilities | 1,206 | 1,938 |
| Total Liabilities | 6,675 | 7,961 |
| Commitments and Contingencies (Note 7) | | |
| Shareholders' Equity: | | |
| Preferred stock, \$0.005 par value, 873 shares authorized, no shares issued or outstanding | | |
| Common stock, \$0.005 par value; 50,000 shares authorized; 6,470 and 6,349 shares issued and 5,802 and 5,681 shares outstanding, respectively | 32 | 32 |
| Additional paid-in capital | 34,941 | 34,275 |
| Accumulated deficit | (15,828) | (11,820) |
| Less - Treasury stock, at cost, 668 shares | (10,082) | (10,082) |
| Accumulated other comprehensive loss | (1,634) | (1,634) |
| Total Shareholders' Equity | 7,429 | 10,771 |
| Total Liabilities and Shareholders' Equity | \$ 14,104 | \$ 18,732 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended September 30, 2023 | 2022 | Nine Months Ended September 30, 2023 | 2022 |
|---|---|--------------|--|---------------|
| Revenues | \$ 5,704 | \$ 6,516 | \$ 17,100 | \$ 19,537 |
| Cost of revenues | <u>3,613</u> | <u>4,184</u> | <u>10,745</u> | <u>12,492</u> |
| Gross profit | 2,091 | 2,332 | 6,355 | 7,045 |
| Operating expenses: | | | | |
| General & administrative | 2,200 | 1,588 | 5,291 | 4,360 |
| Marketing & selling | 723 | 791 | 2,258 | 2,409 |
| Research & development | 275 | 328 | 859 | 1,003 |
| Total Operating expenses | <u>3,198</u> | <u>2,707</u> | <u>8,408</u> | <u>7,772</u> |
| Operating loss | (1,107) | (375) | (2,053) | (727) |
| Other income (expense): | | | | |
| Settlement | - | - | (500) | - |
| Other | - | (8) | (9) | 49 |
| Total other income (expense), net | <u>-</u> | <u>(8)</u> | <u>(509)</u> | <u>49</u> |
| Loss before provision for (benefit from) income taxes | (1,107) | (383) | (2,562) | (678) |
| Provision for (benefit from) income taxes | <u>992</u> | <u>(286)</u> | <u>647</u> | <u>(282)</u> |
| Net loss | \$ (2,099) | \$ (97) | \$ (3,209) | \$ (396) |
| Basic net loss per share | \$ (0.36) | \$ (0.02) | \$ (0.56) | \$ (0.07) |
| Diluted net loss per share | \$ (0.36) | \$ (0.02) | \$ (0.56) | \$ (0.07) |
| Dividends declared per share | \$ - | \$ 0.07 | \$ 0.14 | \$ 0.14 |

See accompanying notes to condensed consolidated financial statements.

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

For the Three Months Ended
September 30, 2023

| | Common Stock, \$0.005 par value | | | Additional | | | Accumulated Other Comprehensive Loss | Total |
|-----------------------------|---------------------------------|--------|-----------|----------------|-------------|-------------|---|----------|
| | Common Shares | Common | Paid-In | Treasury Stock | | Accumulated | | |
| | Outstanding | Stock | Capital | Shares | Cost | Deficit | | |
| BALANCE, June 30, 2023 | 6,411 | \$ 32 | \$ 34,540 | 668 | \$ (10,082) | \$ (13,729) | \$ (1,634) | \$ 9,127 |
| Shares issued – vested | 59 | - | - | - | - | - | - | - |
| Stock-based compensation | - | - | 401 | - | - | - | - | 401 |
| Net loss | - | - | - | - | - | (2,099) | - | (2,099) |
| BALANCE, September 30, 2023 | 6,470 | \$ 32 | \$ 34,941 | 668 | \$ (10,082) | \$ (15,828) | \$ (1,634) | \$ 7,429 |

For the Nine Months Ended
September 30, 2023

| | Common Stock, \$0.005 par value | | | Additional | | | Accumulated Other Comprehensive Loss | Total |
|--|---------------------------------|--------|-----------|----------------|-------------|-------------|---|-----------|
| | Common Shares | Common | Paid-In | Treasury Stock | | Accumulated | | |
| | Outstanding | Stock | Capital | Shares | Cost | Deficit | | |
| BALANCE, December 31, 2022 | 6,349 | \$ 32 | \$ 34,275 | 668 | \$ (10,082) | \$ (11,820) | \$ (1,634) | \$ 10,771 |
| Shares issued – vested | 121 | - | (1) | - | - | - | - | (1) |
| Tax withholding related to vested shares from employee stock plans | - | - | (54) | - | - | - | - | (54) |
| Stock-based compensation | - | - | 721 | - | - | - | - | 721 |
| Cash dividends (\$0.07 per share) | - | - | - | - | - | (799) | - | (799) |
| Net loss | - | - | - | - | - | (3,209) | - | (3,209) |
| BALANCE, September 30, 2023 | 6,470 | \$ 32 | \$ 34,941 | 668 | \$ (10,082) | \$ (15,828) | \$ (1,634) | \$ 7,429 |

For the Three Months Ended
September 30, 2022

| | Common Stock, \$0.005 par value | | | Additional | | | Accumulated Other Comprehensive Loss | Total |
|-----------------------------------|---------------------------------|--------|-----------|----------------|-------------|-------------|---|-----------|
| | Common Shares | Common | Paid-In | Treasury Stock | | Accumulated | | |
| | Outstanding | Stock | Capital | Shares | Cost | Deficit | | |
| BALANCE, June 30, 2022 | 6,294 | \$ 31 | \$ 33,863 | 668 | \$ (10,082) | \$ (10,242) | \$ (1,634) | \$ 11,936 |
| Shares issued – vested | 19 | 1 | (1) | - | - | - | - | - |
| Stock-based compensation | - | - | 277 | - | - | - | - | 277 |
| Cash dividends (\$0.07 per share) | - | - | - | - | - | (394) | - | (394) |
| Net loss | - | - | - | - | - | (97) | - | (97) |
| BALANCE, September 30, 2022 | 6,313 | \$ 32 | \$ 34,139 | 668 | \$ (10,082) | \$ (10,733) | \$ (1,634) | \$ 11,722 |

For the Nine Months Ended
September 30, 2022

| | Common Stock, \$0.005 par value | | | Additional | | | Accumulated Other Comprehensive Loss | Total |
|--|---------------------------------|--------|-----------|----------------|-------------|-------------|---|-----------|
| | Common Shares | Common | Paid-In | Treasury Stock | | Accumulated | | |
| | Outstanding | Stock | Capital | Shares | Cost | Deficit | | |
| BALANCE, December 31, 2021 | 6,257 | \$ 31 | \$ 33,478 | 668 | \$ (10,082) | \$ (9,550) | \$ (1,634) | \$ 12,243 |
| Exercise of stock options | 1 | - | 4 | - | - | - | - | 4 |
| Shares issued – vested | 55 | 1 | (1) | - | - | - | - | - |
| Tax withholding related to vested shares from employee stock plans | - | - | (36) | - | - | - | - | (36) |
| Stock-based compensation | - | - | 694 | - | - | - | - | 694 |

| | | | | | | | | |
|-----------------------------------|--------------|--------------|------------------|------------|--------------------|--------------------|-------------------|------------------|
| Cash dividends (\$0.07 per share) | - | - | - | - | - | (787) | - | (787) |
| Net loss | - | - | - | - | - | (396) | - | (396) |
| BALANCE, September 30, 2022 | <u>6,313</u> | <u>\$ 32</u> | <u>\$ 34,139</u> | <u>668</u> | <u>\$ (10,082)</u> | <u>\$ (10,733)</u> | <u>\$ (1,634)</u> | <u>\$ 11,722</u> |

See accompanying notes to condensed consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|--|-----------------|
| | 2023 | 2022 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (3,209) | \$ (396) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 1,394 | 1,836 |
| ROU asset amortization | 701 | 718 |
| Deferred income taxes | 698 | (775) |
| Stock-based compensation | 721 | 694 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (857) | (837) |
| Prepaid expenses and other current assets | (388) | (11) |
| Income tax receivable | (43) | 1,875 |
| Accounts payable | 369 | (137) |
| Operating lease liabilities | (797) | (757) |
| Accrued expenses | (731) | 786 |
| Net cash used in operating activities | (2,142) | 2,996 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of equipment and leasehold improvements | (24) | (60) |
| Cost of internally developed software | (108) | (103) |
| Other assets | (32) | (25) |
| Net cash used in investing activities | (164) | (188) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of stock, net of tax withholding | (55) | (32) |
| Payments of equipment debt financing | (220) | (523) |
| Cash dividends paid | (799) | (787) |
| Net cash used in financing activities | (1,074) | (1,342) |
| Net decrease in cash and cash equivalents | (3,380) | 1,466 |
| Cash and cash equivalents, beginning of period | 4,750 | 1,992 |
| Cash and cash equivalents, end of period | \$ 1,370 | \$ 3,458 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid for interest | \$ 14 | \$ 36 |
| Cash paid for operating leases | \$ 874 | \$ 849 |
| Right-of-use assets acquired through operating leases | \$ 86 | \$ 78 |

See accompanying notes to condensed consolidated financial statements.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

The interim condensed consolidated financial statements of Psychemedics Corporation (the "Company") presented herein, have been prepared pursuant to the rules of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all the information and note disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2022, included in the Company's 2022 Annual Report on Form 10-K ("10-K"), as filed with the SEC.

The accompanying condensed consolidated financial statements are unaudited but, in the opinion of management, include all adjustments necessary for a fair presentation of results for these interim periods. Except as otherwise disclosed, all such adjustments are of a normal recurring nature. The condensed consolidated balance sheet as of December 31, 2022, has been derived from the Company's annual financial statements that were audited by an independent registered public accounting firm, but does not include all the information and footnotes required for complete annual financial statements. The Company's comprehensive (loss)/income is equal to its net (loss)/income for all periods presented.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The results of operations for the three and nine months ended September 30, 2023, may not be indicative of the results that may be expected for the year ending December 31, 2023, or any other period.

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

2. Financial Information

Liquidity and Management's Plans

At September 30, 2023, the Company's principal sources of liquidity included approximately \$1.4 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, including equipment financing obligations, and capital expenditures for at least the next 12 months. 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 but are not limited to, issuance of common stock, debt financing, lines of credit, or equipment leasing, although there is no assurance that such financings will be available to the Company on terms it deems acceptable, if at all.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

2. Financial Information (continued)

Accounts Receivable

The Company believes its allowance for credit losses related to its accounts receivable remained adequate as of September 30, 2023, due to the essential nature of its customers' respective businesses, as well as the diversity of its large customer base. While the Company anticipates there could be an increase in the aging of its accounts receivable, the Company does not anticipate a significant increase in default risk.

Recently Adopted Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"), which modifies the measurement of expected credit losses on certain financial instruments. The Company adopted ASU 2016-13 in the first quarter of 2023 utilizing the modified retrospective transition method. Based on the composition of the Company's investment portfolio, current market conditions, and historical credit loss activity, the adoption of ASU 2016-13 has not had and is not expected to have a material impact on the condensed consolidated financial statements and disclosures.

3. Fair Value Measurements

The following tables present information about the Company's financial assets and liabilities measured at fair value on a recurring basis and indicate the level of the fair value hierarchy utilized to determine such fair values (in thousands):

| | September 30, 2023 | <u>Fair Value Measurements at Reporting Date Using</u> | | | | |
|------------------------|-----------------------|---|---|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | | |
| Assets: | | | | | | |
| Cash equivalents | | | | | | |
| Money market funds | \$ 505 | \$ 505 | \$ - | \$ - | | |
| Total cash equivalents | <u>\$ 505</u> | <u>\$ 505</u> | <u>\$ -</u> | <u>\$ -</u> | | |

As of September 30, 2023, the Company's cash equivalents were invested in money market funds which were valued based on Level 1 inputs. As of December 31, 2022, the Company did not invest in money market funds or other types of cash equivalents. The Company did not have any financial assets or liabilities during any of the periods presented in the accompanying consolidated financial statements that required Level 2 or 3 inputs.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The carrying values of the Company's accounts payable and accrued expenses approximate their fair values due to the short-term nature of these liabilities and as such these are considered Level 1 in the fair value hierarchy.

4. Stock-Based Compensation

The Company's 2006 Incentive Plan (the "Plan") provides for cash-based awards or the grant or issuance of stock-based awards. As of September 30, 2023, 277 thousand shares remained available for future grant under the Plan.

On August 17, 2023, the Company granted Brian Hullinger, in connection with the commencement of his employment as the Company's Chief Executive Officer and President, as an inducement grant outside of the Plan, under Nasdaq Listing Rule 5635(c)(4), options to acquire 300,000 shares of common stock. The options have a ten-year term and an exercise price of \$4.64 per share, the closing price per share of Psychemedics Corporation common stock as reported by Nasdaq on August 17, 2023. The options were awarded in three tranches. Under the first tranche, option awards covering up to 100,000 shares vest over two years, with 50% of the original number of shares underlying the option vesting on the one-year anniversary of the date of grant and 50% on the two-year anniversary of the grant, subject to continued service with the Company through the applicable vesting dates. Under the second and third tranches, options to acquire 100,000 shares each were granted and each becomes exercisable in full only upon the attainment and continuation in effect for a specified period of time of a particular stock price on the Nasdaq Stock Market.

In addition, on September 21, 2023, the Company granted Shannon Shoemaker, in connection with the commencement of her employment as the Company's Chief Revenue Officer, grants of options to acquire 120,000 shares of common stock. The options have a ten-year term and an exercise price of \$3.66 per share, the closing price per share of Psychemedics Corporation common stock as reported by Nasdaq on September 21, 2023. The options were awarded in three tranches. Under the first tranche, option awards covering up to 40,000 shares vest over two years, with 50% of the original number of shares underlying the option vesting on the one-year anniversary of the date of grant and 50% on the two-year anniversary of the grant, subject to continued service with the Company through the applicable vesting dates. Under the second and third tranches, options to acquire 40,000 shares each were granted and each becomes exercisable in full only upon the attainment and continuation in effect for a specified period of time of a particular stock price on the Nasdaq Stock Market.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------------|------------------------------------|---------------|
| | 2023 | 2022 | 2023 | 2022 |
| <u>Stock-based compensation related to:</u> | | | | |
| Stock option grants | \$ 39 | \$ 20 | \$ 73 | \$ 114 |
| Stock unit awards | 362 | 257 | 648 | 580 |
| Total stock-based compensation | \$ 401 | \$ 277 | \$ 721 | \$ 694 |

There was no income tax benefit recognized in the condensed consolidated statements of operations for stock-based compensation arrangements for the three and nine months ended September 30, 2023, and 2022.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

4. Stock-Based Compensation (continued)

A summary of the Company's stock option activity for the nine months ended September 30, 2023, is as follows (in thousands except per share amounts and years):

| | Number of Shares | Weighted Average Exercise Price Per Share | Remaining Contractual Life (years) | Weighted Average | Aggregate Intrinsic Value(1) |
|---------------------------------|------------------|---|------------------------------------|------------------|------------------------------|
| Outstanding, December 31, 2022 | 508 | \$ 14.19 | 5.1 | \$ 25 | |
| Granted | 120 | \$ 3.66 | | | |
| Canceled | (66) | \$ 14.70 | | | |
| Forfeited | (11) | \$ 4.07 | | | |
| Outstanding, September 30, 2023 | <u>551</u> | <u>\$ 11.87</u> | 4.9 | \$ 11 | |
| Exercisable, September 30, 2023 | <u>431</u> | <u>\$ 14.40</u> | 4.2 | \$ 6 | |

(1) Intrinsic value is calculated based on the amount by which the closing market value of the Company's stock exceeded the exercise price of the underlying options, multiplied by the number of shares.

A summary of the Company's stock unit award ("SUA") activity for the nine months ended September 30, 2023, is as follows (in thousands except per share amounts):

| | Number of Shares | Weighted Average Grant-Date Fair Value Per Share |
|--|------------------|--|
| Outstanding & Unvested, December 31, 2022 | 238 | \$ 6.10 |
| Granted | 91 | \$ 4.64 |
| Converted to common stock | (121) | \$ 6.55 |
| Cancelled | (11) | \$ 6.54 |
| Forfeited | (36) | \$ 5.66 |
| Outstanding & Unvested, September 30, 2023 | <u>161</u> | <u>\$ 5.23</u> |

As of September 30, 2023, 1.1 million shares of common stock were reserved for issuance under the Plan and compensation arrangement outside the Plan. As of September 30, 2023, the unamortized fair value of awards relating to outstanding SUAs and options was \$ 762 thousand, which is expected to be amortized over a weighted average period of 2.1 years.

During the third quarter of 2023, the Board of Directors approved the accelerated vesting of 44 thousand SUAs to the former Chief Executive Officer, and 6 thousand shares to an independent director, both upon retirement, during the three and nine months ended September 30, 2023, respectively. The Company determined the value of each modification to be \$185 thousand and \$25 thousand for the three months ended September 30, 2023, which is included in stock-based compensation in the accompanying consolidated financial statements.

During the third quarter of 2022, the Board of Directors approved the accelerated vesting of 19 thousand and 35 thousand SUAs to certain directors, upon retirement, of the Company during the three and nine months ended September 30, 2022, respectively. The Company determined the value of the modifications to be \$118 thousand and \$230 thousand during the three and nine months ended September 30, 2022, respectively, which is included in stock-based compensation in the accompanying consolidated financial statements.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

5. Income Taxes

Our effective tax rates for the three and nine months ended September 30, 2023, differ from the statutory rate primarily due to a valuation allowance recorded against our U.S. federal and state deferred tax assets. We recorded an \$692 thousand valuation allowance in the third quarter of 2023 based on an assessment of available positive and negative evidence, including being in a three-year cumulative loss position in the U.S., projections of future taxable income, and other quantitative and qualitative information. We intend to maintain a full valuation allowance on our U.S. federal and state net deferred tax assets until there is sufficient positive evidence to support the reversal of all or some portion of the valuation allowance.

6. Basic and Diluted Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing net loss by the weighted average number of common and dilutive common equivalent shares outstanding during the period when the effect is dilutive. The number of dilutive common equivalent shares outstanding during the period was determined in accordance with the treasury-stock method. Common equivalent shares consisted of common stock issuable upon the exercise of outstanding options and common stock issuable upon the vesting of outstanding, unvested SUAs. Basic and diluted weighted average common shares outstanding for the three and nine months ended September 30, 2023, and 2022, were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------|------------------------------------|-------|
| | 2023 | 2022 | 2023 | 2022 |
| Weighted average common shares outstanding, basic | 5,755 | 5,638 | 5,718 | 5,613 |
| Dilutive common equivalent shares | - | - | - | - |
| Weighted average common shares outstanding, diluted | 5,755 | 5,638 | 5,718 | 5,613 |

The computation of diluted loss per share for the three and nine months ended September 30, 2023, excludes the effect of the potential exercise of stock awards, including stock options, when the effect is anti-dilutive. For the three and nine months ended September 30, 2023, the number of antidilutive stock awards excluded from diluted loss per share were 524 thousand and 513 thousand, respectively.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

7. Commitments and Contingencies

From time to time, the Company is a party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. When the Company becomes aware of a claim or potential claim, it assesses the likelihood of any loss or exposure. In accordance with authoritative guidance, the Company records loss contingencies in its financial statements only for matters in which losses are probable and can be reasonably estimated. The Company continuously assesses the potential liability related to the Company's pending litigation and revises its estimates when additional information becomes available. Although it is difficult to predict the ultimate outcome of these cases, management believes, that any ultimate liability would not have a material adverse effect on the consolidated statements of operations. However, an unforeseen unfavorable development in any of these cases could have a material adverse effect on the statements of operations or cash flows in the period in which it is recorded. Developments in legal proceedings and other matters that could cause changes in the amounts previously accrued are evaluated each reporting period.

Settlements

As previously reported in the 10-K, on December 6, 2021, the Company entered into a binding Memorandum of Understanding to settle a purported class action lawsuit related to certain California wage and hour laws. The lawsuit, Enma Sagastume v. Psychemedics Corporation, Case No. 2:20-CV-06624-DSF, is pending in the United States District Court for the Central District of California (the "California Lawsuit") and is similar to numerous lawsuits filed against employers with operations in California. The Company has accrued \$1.2 million as of September 30, 2023, related to the California Lawsuit, which is included in accrued expenses on the accompanying consolidated balance sheets and which was paid in full on November 2, 2023.

As previously reported in a Current Report on Form 8-K filed on July 21, 2023, on July 17, 2023, the Company entered into a Confidential Settlement Agreement and Release (the "Agreement") in connection with a contract dispute regarding the Company's alleged contractual obligations for work performed by a consultant for advice on strategic negotiations with a shipping carrier. The Agreement provided that the settlement amount of \$0.5 million would be paid in three equal installments as follows: on or before August 17, 2023, on or before December 31, 2023, and on or before December 31, 2024. The Company paid one installment before August 17, 2023. The Company believes that the allegations lack merit and agreed to the enter into the Agreement to settle claims in order to avoid potential significant fees and a general distraction. The Company has accrued \$0.3 million as of September 30, 2023, related to the Agreement, which is included in accrued expenses on the accompanying consolidated balance sheets.

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

8. Operating Leases

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

As of September 30, 2023, the Company recognized a Right-Of-Use ("ROU") asset of \$ 2.1 million and an operating lease liability of \$ 2.3 million based on the net present value of the minimum lease payments. The weighted average discount rate used for leases as of September 30, 2023, is 3.9%. The weighted average lease term as of September 30, 2023, is 2.9 years. The operating lease expense for the three and nine months ended September 30, 2023, was \$258 thousand and \$779 thousand, respectively.

Maturities and balance sheet presentation of the Company's lease liabilities for all operating leases as of September 30, 2023, is as follows (in thousands):

| | |
|--|-----------------|
| October 1, 2023, through December 31, 2023 | \$ 293 |
| 2024 | 1,106 |
| 2025 | 564 |
| 2026 | 460 |
| Total lease payments | 2,423 |
| Less: interest | (159) |
| Present value of lease liabilities | <u>\$ 2,264</u> |
| | |
| Current operating lease liabilities | \$ 1,058 |
| Long-term operating lease liabilities | 1,206 |
| | \$ 2,264 |

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

9. Debt

On March 20, 2014, the Company entered into an equipment financing arrangement ("Loan Agreement") with Banc of America Leasing & Capital, which it amended on August 8, 2014, September 15, 2015, October 30, 2017, and December 2, 2019. The terms of the arrangement are detailed in the 10-K.

The weighted average interest rate on outstanding debt under the Loan Agreement was 3.8% for the three and nine months ended September 30, 2023. The interest expense was \$4 thousand and \$14 thousand for the three months and nine months ended September 30, 2023. As of September 30, 2023, the weighted average interest rate was 3.8% and there was \$ 379 thousand of outstanding debt related under the Loan Agreement. The Company was in compliance with all loan covenants under the Loan Agreement as of September 30, 2023.

The remaining principal repayment requirements for debt obligations as of September 30, 2023, were as follows (in thousands):

| | |
|--|--------------|
| October 1, 2023, through December 31, 2023 | \$ 74 |
| 2024 | 305 |
| Long-term debt from equipment financing | 379 |
| Less: current portion of long-term debt from equipment financing | (302) |
| Long-term debt from equipment financing, net of current portion | <u>\$ 77</u> |

PSYCHEMEDICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

10. Revenue

The table below disaggregates our external revenue by major source (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
| | 2023 | 2022 | 2023 | 2022 |
| Testing | \$ 4,864 | \$ 5,554 | \$ 14,416 | \$ 16,759 |
| Shipping/Collection (hair) | 819 | 937 | 2,614 | 2,687 |
| Other | 21 | 25 | 70 | 91 |
| Total Revenue | \$ 5,704 | \$ 6,516 | \$ 17,100 | \$ 19,537 |

11. Significant Customers

The Company had one customer that represented 14% of revenue for the nine months ended September 30, 2023. The Company had no customers that represented over 10% of revenue for the nine months ended September 30, 2022. The Company had one customer that represented 27% and 14% of the total accounts receivable balance as of September 30, 2023, and 2022, respectively.

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 that involves risks and uncertainties. In particular, statements contained in this report that are not historical facts (including but not limited to statements concerning earnings, earnings per share, revenues, cash flows, dividends, future business, growth opportunities, profitability, pricing, new accounts, customer base, market share, test volume, sales and marketing strategies, market demand for drug testing services in the U.S. and foreign drug testing laws and regulations, required investments in plant, equipment and people and new test development) may be "forward looking" statements. 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 changes in U.S. and foreign government regulations, including but not limited to FDA regulations, R&D spending, competition (including, without limitation, competition from other companies pursuing the same growth opportunities), the Company's ability to maintain its reputation and brand image, the ability of the Company to achieve its business plans, cost controls, the continued labor shortage, leveraging of its global operating platform, risks of information technology system failures and data security breaches, the uncertain global economy, the Company's ability to attract, develop and retain executives and other qualified employees and independent contractors, including distributors, the Company's ability to obtain and protect intellectual property rights, litigation risks, and general economic conditions.

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

RESULTS OF OPERATIONS

Revenue decreased 12% for the three months ended September 30, 2023, compared to the same period in 2022, primarily due to a decrease in volumes from the Company's base business. The Company's revenues were impacted by lower volumes from customers experiencing the effects of the general economic conditions, continued labor shortage related to hiring and changing customer priorities. For the nine months ended September 30, 2023, revenue decreased \$2.4 million or 12%, primarily due to a decrease in volumes from the Company's base business.

Gross profit decreased 9% or to \$2.1 million for the three months ended September 30, 2023, compared to \$2.3 million for the same period in 2022. Cost of revenues decreased by \$0.6 million or 14% for the three months ended September 30, 2023, compared to the same period in 2022. Gross profit for the nine months ended September 30, 2023, was \$6.4 million, a decrease of \$0.7 million from the comparable period in 2022. Gross profit percentage for the nine month period ended September 30, 2023, was 37% compared to 36% for the comparable period in 2022. The increase in gross profit percentage was primarily due to cost reduction programs offset by lower total revenues for both the three and nine months ended September 30, 2023.

General and administrative ("G&A") expenses increased 38% or \$0.6 million to \$2.2 million for the three months ended September 30, 2023, compared to \$1.6 million for the same period in 2022. As a percentage of revenue, G&A expenses were 39% and 24% for the three months ended September 30, 2023, and 2022, respectively. G&A expenses were \$5.3 million and \$4.4 million for the nine months ended September 30, 2023, and 2022, respectively. The increase in G&A expenses for both the three and nine months ended September 30, 2023, was primarily due to higher costs associated with legal fees, CEO succession plan execution, accounting and consulting fees, and business insurance premiums. As a percentage of revenue, G&A expenses were 31% and 22% for the nine months ended September 30, 2023, and 2022, respectively.

Marketing and selling expenses decreased 13% or \$0.1 million to \$0.7 million for the three months ended September 30, 2023, compared to \$0.8 million for the same period in 2022. Total marketing and selling expenses represented 13% and 12% of revenue for the three months ended September 30, 2023, and 2022. The decrease in marketing and selling was primarily driven by lower personnel costs. Marketing and selling expenses were \$2.3 million and \$2.4 million for the nine months ended September 30, 2023, and 2022, respectively. As a percentage of revenue, marketing and selling expenses were 13% and 12% for the nine months ended September 30, 2023, and 2022, respectively.

Research and development ("R&D") expenses were flat at \$0.3 million for both the three months ended September 30, 2023, and 2022. R&D expenses represented 5% of revenue for the three months ended September 30, 2023, and 2022. R&D expenses were \$0.9 million and \$1.0 million for the nine months ended September 30, 2023, and 2022, respectively. R&D expenses represented 5% of revenue for the nine months ended September 30, 2023, and 2022.

Provision for (benefit from) income taxes consisted primarily of federal and state income taxes in the United States. We estimate income taxes in each of the jurisdictions in which we operate. During the three months ended September 30, 2023, the Company recorded a tax provision of \$1.0 million (effective tax rate of 90%) and a tax benefit of 286 thousand (effective tax rate of 75%) for the comparable period in 2022. During the nine months ended September 30, 2023, the Company recorded a tax provision of \$647 thousand (effective tax rate of 25%) and a tax benefit of \$282 thousand (effective tax rate of 42%) for the comparable period in 2022.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2023, the Company had approximately \$1.4 million of cash and cash equivalents. The Company's operating activities used net cash of \$2.1 million for the nine months ended September 30, 2023. Investing activities used \$0.2 million of net cash while financing activities used \$1.1 million of net cash for the nine months ended September 30, 2023.

Cash used in operating activities of \$2.1 million reflected net loss of \$3.2 million adjusted for depreciation and amortization of \$1.4 million, ROU asset amortization of \$0.6 million and stock-based compensation of \$0.7 million. This was also impacted by an increase in operating assets of \$1.3 million and a decrease in operating liabilities of \$1.1 million.

Cash used in investing activities of \$0.2 million was primarily related to internally developed software and equipment purchases. We anticipate spending less than \$0.3 million in additional capital purchases for the remainder of 2023.

Cash used in financing activities of \$1.1 million included cash dividends to shareholders of \$0.8 million and \$0.2 million from payments on equipment debt financing.

Contractual obligations and other commercial commitments as of September 30, 2023, included legal settlement commitments, operating lease commitments, and outstanding debt, described in Notes 7, 8, and 9, respectively of the Notes to Condensed Consolidated Financial Statements.

While management currently believes that its existing funds and cash flow from operations should be adequate to fund the Company's business for at least the next 12 months, adverse economic conditions could adversely affect the Company's future operating results and cash flows. 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 but are not limited to, issuance of common stock or debt financing, lines of credit, or equipment leasing, although there is no assurance that such financings will be available to the Company on terms it deems acceptable, if at all.

Item 4. Controls and Procedures

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

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

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

Information pertaining to legal proceedings can be found in Item 1. Financial Statements and Supplementary Data – Note 6 “Commitments and Contingencies”.

Item 1A. Risk Factors

Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2022, includes a discussion of our risk factors. There have been no material changes in the risk factors described in such report.

Item 2. Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities

There were no purchases of treasury stock in the first nine months of 2023.

Item 6. Exhibits

| | |
|----------------------|--|
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | Inline XBRL Instance Document |
| 101.SCH | Inline XBRL Taxonomy Extension Schema |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

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.

Psychededics Corporation

Date: November 13, 2023

By: /s/ Brian Hullinger
Brian Hullinger
Chief Executive Officer and President

Exhibit 31.1

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

I, Brian Hullinger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Psychomedics Corporation ("the registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined by Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2023

/s/ Brian Hullinger

Brian Hullinger
Chief Executive Officer and President
(principal executive officer)

Exhibit 32.1

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

I, Brian Hullinger, Chief Executive Officer and President of Psychomedics Corporation (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as the principal executive officer of the Company, that:

- (1) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2023, as filed with the Securities and Exchange Commission on November 13, 2023 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 13, 2023

Is/ Brian Hullinger

Brian Hullinger
Chief Executive Officer and President
(principal executive officer)