NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
TO BE HELD ON NOVEMBER 16, 2004

TO THE STOCKHOLDERS:

NOTICE IS HEREBY GIVEN that a Special Meeting of Stockholders (the "Special Meeting") of PharmChem, Inc., a Delaware corporation (the "Company"), will be held on November 16, 2004, at 10:00 a.m., local time, at the Company's offices 2411 E. Loop 820 N., Fort Worth, TX 76118 for the following purposes:

1. To elect four directors to serve for the ensuing year and until their successors are duly elected and qualified.

2. To consider and take action upon the resolutions adopted by the Board of Directors of the Company that the Company should sell certain significant assets of the Company (the "Proposed Asset Sale") to Kroll Laboratory Specialists ("Kroll") and that the Company should be dissolved and liquidated (the "Plan of Dissolution"), and to authorize such further actions as may be necessary or desirable to consummate the Proposed Asset Sale and the Plan of Dissolution.

3. To transact such other business as may properly come before the Special Meeting or any adjournment thereof.

Only stockholders of record at the close of business on October 15, 2004 are entitled to notice of and to vote at the Special Meeting. To assure your representation at the Meeting, please mark, sign, date and return the enclosed proxy as promptly as possible in the postage-prepaid envelope enclosed for that purpose. If you attend the Meeting, you may vote in person even if you return a proxy.

David A. Lattanzio
Secretary

Haltom City, Texas
October 21, 2004

IMPORTANT: Whether or not you plan to attend the Special Meeting, you are requested to complete and promptly return the enclosed proxy in the envelope provided.

October 21, 2004

To Our Stockholders:

I am writing to tell you that the time has come for us to exit the drug-testing business and commence the liquidation of the Company. While not a pleasant task, given the series of negative developments in our business which we have been telling you about over the last few years, there are no viable alternatives. As you can see from the enclosed Notice of Special Meeting, we are therefore calling a special meeting of our stockholders primarily to request your approval for a sale of some of our significant assets and the dissolution and liquidation of the Company.

Background

As you well know, our business has declined considerably beginning with the economic downturn commencing in late 2001. Pre-employment drug testing has decreased dramatically while budget constraints at the federal and state levels have placed downward pressure on their drug testing programs. Additionally, many of our customers have migrated from laboratory testing to far less costly onsite devices. All of these factors contributed to lower lab volume thereby resulting in an inefficient level of operations. We experienced losses in 2001, 2002 (excluding our gain on the sale of Medscreen) and 2003. The expected benefits from our relocation to Texas from California in 2001 could not be realized as volume losses resulting from the above noted factors significantly drained our cash resources.

In October 2003, our largest customer, the Administrative Office of United States Courts (AOUSC), awarded its laboratory drug testing contract to three other laboratories. We had performed all of AOUSC's drug testing work for the prior 15 years and, as a result of the loss of that contract, we experienced an annualized revenue loss of nearly $7.2 million or 27% of our 2003 sales. While we vigorously protested this action by AOUSC and sought local congressional assistance, we were unsuccessful in reversing the decision.

Our principal lender reacted to the announcement of the loss of the AOUSC contract by insisting that we amend our loan agreement in January 2004 to require us to pay down $650,000 of our term debt and double our monthly principal payments, resulting in the full payment of our term debt at the end of July. Had the bank not imposed these requirements, we believe that we would have had sufficient cash resources to operate for an additional six to nine months.

In the fourth quarter of 2003, management decided to explore options to exit the business. The audit report on our 2003 financial statements questioned our ability to continue operations as a "going concern." At the time their report was issued, we announced that we were seeking joint venture opportunities, the sale of all or a portion of our assets or a merger with another company. We also then disclosed that, should these efforts fail, we may be required to seek bankruptcy protection or commence a liquidation or other administrative proceeding.

We have made numerous attempts to secure additional financing and/or sell some or all of our assets. We engaged an investment banker and information packets were distributed to over 1,000 prospects. Unfortunately, there was little or no interest other than the offers described below which originated as a result of management contacts.

In July of this year, we were notified by Sears, Roebuck & Company (Sears) that it had awarded its drug testing contract to another company. Sears had been a PharmChem customer for nearly seven years. The winning bid for the Sears work was priced below our variable cost and, for obvious reasons, we refused to meet this pricing. In 2003, Sears generated revenues of $3.9 million or 15% of our sales. In August of this year Lowes Companies (Lowes) transferred its managed work place drug testing business to another lab. Our 2003 sales to Lowes amounted to $3.6 million or 12% of sales. Earlier this month the U.S. Department of the Interior notified us that the government agency scheduling work that we had been performing was being transferred to another company. We understand that the winning bid for that work was also below our variable cost. Our 2003 sales to DOI were $1.5 million or 6% of our sales.

As we have told you, during the past three years we have taken significant steps to reduce our cost structure, including layoffs of nearly 150 people through last month (62% of our August 31, 2001 work force), a reduction in salaries of between 5% and 25% for our most highly compensated employees, including all of our current executive officers, a company-wide wage and salary freeze and the reduction of our legal, accounting and related expenses. We vigorously pursued volume by pricing aggressively; however, the significant amount of excess capacity in the industry made it difficult to secure new business while the transition to onsite drug testing reduced the demand for lab based testing. Unfortunately, these cost reductions were not enough to overcome the loss of laboratory volume.

Asset Sales

As a result of our efforts to find buyers for some of our assets, we entered into three separate agreements to sell certain of our trademarks and customer lists. Two of these transactions have been completed.

In August 2004 we sold to Kroll Laboratory Specialists, Inc. (Kroll) the customer list and trademarks related to our onsite drug testing business (which generated $1.2 million in revenue in 2003). We received a cash payment at closing of $300,000 and are entitled to a commission on sales during the succeeding 24 months. Assuming that these customers remain with Kroll and that current sales levels remain stable over that period, we would expect commissions from this sale ranging from approximately $372,000 to $496,000.

In mid-September we sold the customer list related to our managed workplace lab-based drug testing business (which generated $0.4 million in revenues in 2003) to First Advantage Enterprise Screening Corporation (First Advantage) with payment to be generated through sales commissions on this business over the next 18 months. These commissions are estimated to total between approximately $66,600 and $88,800 assuming that these customers remain with First Advantage and that current sales levels remain stable.

Finally, the largest of the transactions into which we have entered relates to our non-managed lab based drug testing business. On September 17, 2004, we entered into an agreement with Kroll pursuant to which Kroll would acquire the customer list related to that business, subject, among other conditions, to the approval of the sale by our stockholders. The purchase price will consist of an initial cash payment of $100,000 plus a commission on sales over the 36 months after the closing. These customers generated revenues in 2003 of $5.4 million. It is anticipated that this sale will generate commissions totaling between approximately $792,000 and $1,059,000. There is, of course, no assurance that these customers will remain with Kroll or that current sales levels will be maintained. In order to allow us to exit our laboratory operations in a timely fashion and to continue past levels of service to our customers, given our limited financial resources, pending the closing of this transaction, these customers' specimens are being processed by Kroll on our behalf under a service agreement.

Once this last transaction has closed, our only remaining business will be the PharmChek® sweat patch. This business had sales of $1.2 million in 2003. While a small group of our employees will continue to handle this business for the time being, our goal is to sell or otherwise dispose of it.

Proposals for Stockholder Consideration

At the Special Meeting, we are therefore seeking to obtain the approval of our stockholders for the sale to Kroll of the customer list relating to our non-managed lab-based business, as well as the dissolution and liquidation of the Company. Our current intention is to file a Certificate of Dissolution with the Delaware Secretary of State following the closing of the asset sale, seek buyers for our remaining business, collect the commissions payable under these agreements and other amounts owing the Company and take whatever other actions are necessary to wind up our affairs. Because the commission stream is expected to run for 36 months, the liquidation process will extend over that period. By approving our plan of dissolution, stockholders will be granting our Board of Directors authority to abandon that plan if it determines that abandonment would be in the best interest of the Company or our stockholders.

During the liquidation period, we will pay our creditors to the extent possible. Taking into account the expected commissions to be received and amounts that we owe, it is unlikely that we will be able to fully repay our creditors (other than our bank which has a first lien on all of our assets) and, unfortunately, there will be nothing left for our stockholders. It should be noted that none of our officers or directors are creditors of PharmChem. It is anticipated that the only officer who will remain with the Company during the liquidation is our current Chief Financial Officer, David Lattanzio, whose total compensation for managing the liquidation process will be at its current annual rate of around $200,000.

In order for us to maximize the amount to be paid to our creditors who have stood with us for many years and avoid the unnecessary expense of a bankruptcy or other court proceeding, we strongly urge our stockholders to approve the asset sale and dissolution. That proposal will require approval by a majority of the outstanding shares of our Common Stock.

We will also be presenting our current Board of Directors for reelection at the meeting to see us through the asset sale and dissolution and the beginning of the liquidation process. More information on our directors can be found in Attachment 1 to this letter. We anticipate paying our directors through 2005 at their current rate of compensation as described in Attachment 1. While I intend to leave the Company shortly in Dave's capable hands, I will remain as a director and will be available to consult with the Company as needed.

I want to personally thank our stockholders for your patience and support over the years and give special thanks to our loyal employees, directors, customers and vendors who have stayed with us through good times and bad.

Sincerely,

Joe Halligan
President and Chief Executive Officer

ATTACHMENT 1

INFORMATION REGARDING ELECTION OF DIRECTORS

Nominees

A board of four directors is to be elected at the Special Meeting. Unless otherwise instructed, the proxy holders will vote the proxies received by them for the four nominees named below, each of whom is currently a PharmChem director. It is important that we retain the services of our directors to help see us through the asset sale and dissolution and the beginning of the liquidation process. The term of office of each person elected as a director will continue until the next Annual Meeting of Stockholders or until a successor has been elected and qualified.

Name	Age	Director Since	Principal Occupation
Joseph W. Halligan	59	1995	President and Chief Executive Officer of the Company
Richard D. Irwin	68	1987	President of Grumman Hill Associates, Inc.
Stephen I. Schorr	58	2001	Partner, Tatum CFO Partners, LLP
Donald R. Stroben	73	1998	Private Investor

Mr. Halligan has been President and Chief Executive Officer of the Company since November 1995. From 1988 to 1995, Mr. Halligan was President and Chief Executive Officer of E.S.I. Consulting Group, a private consulting practice, specializing in advising and operating high growth, consumer and service oriented companies. Before forming his consulting practice, Mr. Halligan served from 1983 to 1987 as President and CEO of a privately-held company, Laura Scudder's, Inc. From 1969 to 1983, Mr. Halligan served as Senior Vice President of Fotomat Corporation and President of its subsidiary, Video Services of America.

Mr. Irwin has been Chairman of the Board of Directors of the Company since November 1995. Mr. Irwin is a co-founder and President of Grumman Hill Associates, Inc., a venture capital firm headquartered in New Canaan, Connecticut. Prior to founding Grumman Hill in 1985, he served as a Managing Director of Dillon, Read & Co., Inc. from 1983 to 1985.

Mr. Schorr has been a director since June 2001 and was appointed Chairman of the Audit Committee at that time. He has been a partner in Tatum CFO Partners, LLP, a national firm of career chief financial officers providing services to growth companies since March, 2000. Mr. Schorr was General Manager, West Coast Operations of the Hain Food Group from 1997 to 1999, and was Chief Financial Officer of Westbrae Natural, Inc., a specialty food distributor and processor from 1988 to 1997. From 1982 to 1988, Mr. Schorr served as Corporate Controller and Chief Financial Officer of Linear Corporation, a consumer electronics manufacturer.

Mr. Stroben has been a director since May 1998. From 1981 to 1999, Mr. Stroben was Managing General Partner of Princeton/Montrose Partners, a venture capital partnership headquartered in Solana Beach, California and Chairman of Stroben & Hahn Inc., its management company. Mr. Stroben is currently a private investor.

Director Compensation

Each Board member who is not also an employee has the right to a fee of $1,000 per meeting attended ($500 for telephonic meetings), as well as an annual retainer fee of $12,000. Each member of the Audit Committee (currently Messrs. Schorr, Stroben and Irwin) has the right to a fee of $500 per meeting attended ($250 for telephonic meetings) that is not on the same date as a Board meeting. Board and Committee members are also reimbursed for their expenses for each meeting attended. The Board has acted primarily by telephone meetings during the past year. While each of our directors holds options to purchase our Common Stock, there is virtually no likelihood that any of those options will have any value.

Executive Officer Compensation

The following table shows the compensation paid, with respect to our three most recent fiscal years, to our Chief Executive Officer and the four most highly compensated executive officers other than the Chief Executive Officer who were serving as executive officers at the end of fiscal 2003 (except as otherwise noted).

	Annual Compensation				Long Term Compensation Awards	
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)** (1)	**Number of Shares of Common Stock Underlying Options Granted (#)**	**All Other Compensation ($)**
Joseph W. Halligan	2003	330,544	0	6,120	0	11,209(2)
President and Chief	2002	347,000	52,000	6,305	20,000	11,018 (3)
Executive Officer	2001	341,231	0	9,552	10,000	9,453(4)
Neil A. Fortner	2003	174,583	0	0	0	9,947(5)
Vice President, Laboratory	2002	172,581	26,000	10,842	20,000	10,169(6)
Operations	2001	158,205	0	35,237	10,000	113,840(7)
David A. Lattanzio	2003	183,314	0	27,600	0	112,265(8)
Vice President,	2002	187,000	28,000	27,600	20,000	10,309(9)
Chief Financial Officer and	2001	187,135	0	27,600	10,000	9,923(10)
Secretary						
Bryan C. Merryman(11)	2003	130,868	0	0	0	10,444(12)
Vice President, Customer Service	2002	128,769	20,000	0	10,000	8,625(13)
	2001	121,115	20,000	0	20,000	80,330(14)
Baburaj K. Parakkal(15)	2003	112,285	0	0	0	9,397(16)
Vice President,	2002	140,000	21,000	0	10,000	11,230(17)
Information Systems	2001	135,846	0	0	10,000	15,118(18)

(1) Housing allowances.
(2) Includes $9,161, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,200 for the Company matching contribution to the 401(k) plan.
(3) Includes $9,170, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,000 for the Company matching contribution to the 401(k) plan.
(4) Includes $7,612, $432 and $149 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,260 for the Company matching contribution to the 401(k) plan.

(5) Includes $8,052, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,047 for the Company matching contribution to the 401(k) plan.
(6) Includes $8,418, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $903 for the Company matching contribution to the 401(k) plan.
(7) Includes $8,127, $432 and $259 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, $1,260 for the Company matching contribution to the 401(k) plan, and $103,762 paid for relocation expenses.
(8) Includes $8,052, $443 and $5,143 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, $1,099 for the Company matching contribution to the 401(k) plan, and $97,528 paid for relocation expenses.
(9) Includes $8,411, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,050 for the Company matching contribution to the 401(k) plan
(10) Includes $7,972, $432 and $259 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $1,260 for the Company matching contribution to the 401(k) plan.
(11) Mr. Merryman resigned as an executive officer of the Company effective December 3, 2003.
(12) Includes $8,664, $443 and $1,337 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively.
(13) Includes $7,592, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $185 for the Company matching contribution to the 401(k) plan.
(14) Includes $5,969, $432 and $259 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, and $73,670 paid for relocation expenses. The bonus paid to Mr. Merryman in 2001 was a hiring incentive.
(15) Mr. Parakkal resigned as an executive officer of the Company effective August 31, 2004.
(16) Includes $4,392, $443 and $988 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, $74 for the Company matching contribution to the 401(k) plan, and $3,500 reimbursement under the Company's tuition reimbursement plan.
(17) Includes $6,039, $443 and $405 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, $506 for the Company matching contribution to the 401(k) plan and $3,837 reimbursement under the Company's tuition reimbursement plan.
(18) Includes $5,969, $432 and $259 for the Company portion of health insurance, group term life insurance and long-term disability premiums, respectively, $606 for the Company matching contribution to the 401(k) plan and $7,852 paid for relocation expenses.

Vote Required

The affirmative vote of a plurality of the votes duly cast is required for the election of a director. Abstentions and broker "non-votes" are counted as present and entitled to vote for purposes of determining a quorum but are not counted for the purposes of the election of directors.