



December 5, 2017

Dear Stockholder:

I am pleased to furnish you with the sixth update on PharmChem, Inc. (the “Company”), our results for the year ended December 31, 2016 and to announce that the Board of Directors approved the declaration of its second dividend of five cents per share to stockholders of record on December 21, 2017, payable on January 8, 2018. As more fully described below, there continue to be several risk factors (as well as some opportunities) and investment requirements facing us. However, after careful consideration of these issues and our projection of future operations and cash flow, we believe this return to our stockholders is appropriate at this time.

We continue to broadcast the attributes of our Sweat Patch for continuous and long-term monitoring of drug dependent clients within federal and state community supervision programs, state managed drug courts, re-entry courts and various treatment programs throughout the U.S.

During 2016, we concentrated our sales and marketing efforts among drug/mental health, tribal, veterans’ and re-entry courts and states operating National Highway Traffic Safety Administration (NHTSA) funded 24/7 sobriety programs or those contemplating such sobriety programs. Four states were awarded new funding under the 2018 NHTSA’s program and another three were awarded continued funding.

Attention to these specific customer channels together with our presence within the federal courts resulted in another year of double digit sales growth. We attended 11 state conferences and presented our device and related lab services at six prominent national conferences where our marketing efforts have reinforced our presence and awareness in these markets. During 2016, we opened 83 new customer accounts.

Another opportunity for us would seemingly be in programs designed to confront the opioid epidemic facing our country. However, many if not all the programs that would counter these addictions will rely heavily on federal funding. The amount of such funding and to whom it will be directed is uncertain at this time. If such funding is allocated to state and local treatment centers as opposed to the medical and mental health communities, we could benefit.

Summary audited financial statements for 2016 and 2015 are attached. Sales increased 29%; operating income rose 58%; net income was up 67%; and cash and cash equivalents increased \$624,996. In 2016, we sold our product and related services in 46 states and four foreign countries—the latter related mainly to research. Our growth in 2017 is expected to ease somewhat but still achieve a double digit increase in sales.

During 2017, we completed the installation of a new IT platform whereby all our computer operations have been outsourced. Also, the complete revamping of our website went live in mid-2017.

The risk factors and challenges facing us continue. The Company needs to invest in further research and development to keep abreast of current trends, new technologies and heavily regulated protocols to which our business continues to be subjected. New FDA regulations relating to recalls and serialization may affect us. However, the adoption by the FDA of regulations related to serialization have been delayed indefinitely. Also, new screening assays will most likely be needed in the near future. We recently



renewed our current laboratory contract which extends the agreement to the end of 2020 with automatic renewals thereafter.

This renewed agreement calls for, among other things, upward and downward pricing depending upon the percentage of specimens screening positive over a certain number of consecutive months. Passing on upward pricing to our customers may prove to be difficult.

Additionally, we renewed our contract with the manufacturer of our Sweat Patch which assures us the ongoing supply of our device and includes automatic annual renewals.

We continue to explore opportunities to present PharmChem, its franchise and strategic value to those companies that can benefit from acquiring us at the appropriate valuation.

Lastly, Dave Lattanzio, our Vice President of Finance, has announced he will wind down his involvement in the day-to-day responsibilities after over 20 years with the Company. Most of his duties and responsibilities will be assumed by our recently hired Vice President & Controller, Shana Veale. Dave will continue to assist Shana and me in selected day-to-day operations while retaining his seat on the Board of Directors.

I appreciate your continued support. Future updates will be made as conditions warrant.

Joseph W. Halligan  
President & Chief Executive Officer  
[jhalligan@pharmchem.com](mailto:jhalligan@pharmchem.com)

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In 2003, the Company filed Form 15 with the Securities and Exchange Commission effectively terminating its registration under the Securities Exchange Act of 1934. The Company has no plans to revoke this filing.

The Company does not believe that it is subject to the Securities Exchange Commission's reporting requirements. Nonetheless, this letter contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933 ("Forward-looking Statements"), which are subject to the "safe harbor" created by these Sections. Forward-looking statements are statements about future financial results, future products or services and other events that have not yet occurred. These forward-looking statements contain words such as, but not limited to, "expect", "anticipate", "estimate", "believe", "will", "may" or "might". Investors should be aware that actual results may differ materially from our expressed expectations because of risks and uncertainties about the future. We will not necessarily update the information in this letter if any forward-looking statement later turns out to be inaccurate.



PharmChem, Inc.  
Summary Balance Sheets  
December 31, 2016 and 2015

	2016 (Audited)	2015 (Audited)
Cash & Cash Equivalents	\$2,928,499	\$2,303,503
Short-Term Securities	19,300	22,897
Receivables, Net	514,095	321,918
Other Current Assets	128,021	153,776
	3,589,915	2,802,094
Property and Equipment, Net	22,770	12,154
Total Assets	\$3,612,685	\$2,814,248
Accounts Payable	\$ 172,005	\$ 229,876
Accrued Expenses	416,809	281,157
Total Liabilities	588,814	511,033
Stockholders' Equity	3,023,871	2,303,215
	\$3,612,685	\$2,814,248



PharmChem, Inc.  
Summary Statements of Operations  
For The Twelve Months Ended December 31, 2016 and 2015

	<u>2016</u> <u>(Audited)</u>	<u>2015</u> <u>(Audited)</u>
Net Sales	\$4,168,305	\$3,233,777
Cost of Goods Sold	1,580,472	1,241,589
Gross Profit	2,587,833	1,992,188
Selling, General & Administrative Expenses	1,555,040	1,338,727
Operating Income	1,032,793	653,461
Dividend Income and Unrealized Gain (Loss) on Securities, Net	3,506	(29,078)
Net Profit Before Taxes	1,036,299	624,383
Provision for Taxes	20,995	16,389
Net Income	<u>\$1,015,304</u>	<u>\$ 607,994</u>