



December 2, 2016

Dear Stockholder:

I am pleased to provide you with the fifth update on PharmChem, Inc. (the “Company”), our results for the year ended December 31, 2015 and to announce that the Board of Directors approved the declaration of a five cents per share dividend to stockholders of record on December 13, 2016, payable on January 4, 2017. As more fully described below, there are a number of risk factors 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, and, in the future, should conditions permit.

The Company continues to emphasize its product and services to state and local supervisory and rehabilitation programs where the ongoing monitoring attributes of our device have proven to be quite popular and cost effective.

During 2015 (and in 2016, as well), we continue to focus our sales and marketing efforts on state and local drug courts, related rehabilitation centers, 24/7 sobriety programs and evidence-based programs. These programs coupled with the resurgence of our business with U.S. Courts, have resulted in a greater presence and awareness of our Sweat Patch, thereby driving our double digit sales growth. Further, our marketing and training programs have successfully reinforced our emphasis in these markets and our expectations are to continue similar programs in the future. As an example of our commitment, in 2015 we attended 12 state and local conferences and presented the Sweat Patch to community stakeholders at five prominent national conferences.

A number of states have or are contemplating the adoption of sobriety programs mirroring somewhat those currently in place in Montana, and North and South Dakota, where we currently enjoy a significant presence. We are, of course, optimistic about this expansion and are planning specific marketing, training and other programs to enhance the use of the Sweat Patch by these states. However, there is no assurance these states will utilize our device as part of their protocols.

Summary audited financial statements for 2015 and 2014 are attached. From 2014 to 2015, sales increased 28%; operating income rose 38%; net income was up 40%; and cash and cash equivalents increased \$682,637. In 2015, we sold our product and related services in 46 states and seven foreign countries—the latter related mainly to research. And, we are seeing similar sales growth in 2016.

Merger and acquisition activity remains one of the Company’s priorities to further optimize stockholder value. We continue to explore opportunities to present PharmChem and its strategic value to those companies that can benefit from acquiring us at the appropriate valuation. We are also looking at acquiring businesses where synergies would be beneficial.

There has been little change in the risk factors and challenges facing us. The Company needs to invest in further research and development in order to keep abreast of current trends and heavily regulated protocols to which our business continues to be subjected. Also, new FDA regulations relating to recalls and serialization may affect the Company’s performance. We will also likely need new screening assays



in the near future. And, the Company must continue to address the dilemma of developing other certified laboratories capable of testing its Sweat Patch.

We are in the preliminary stages of converting our current contractual forensic toxicologist to a full-time position to complement our sales growth, evaluate our research into using our Sweat Patch to screen for other substances and the initial assessment of developing new screening assays. These efforts would require a considerable investment. Further, the Company is investing in a new IT platform and related software to support our growth and we will launch a major revamp to our web site in early 2017 to support current and potential new customers.

Potential buyers likely view these regulatory and risk factors as impediments to acquiring the Company. However, given our sales growth, the initiation of research and development into new screening assays and the screening of other substances, it is believed that the Company's franchise has an inherent value not yet reflected in the market.

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

A handwritten signature in black ink that reads 'Joe Halligan'. The signature is written in a cursive, flowing style.

Joseph W. Halligan
President & Chief Executive Officer
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, 2015 and 2014

	2015 <u>(Audited)</u>	2014 <u>(Audited)</u>
Cash & Cash Equivalents	\$ 2,303,503	\$ 1,620,866
Short-Term Securities	22,897	57,028
Receivables, Net	321,918	303,331
Other Current Assets	153,776	88,462
	<u>2,802,094</u>	<u>2,069,687</u>
Office Equipment	12,154	6,776
Total Assets	<u>\$ 2,814,248</u>	<u>\$ 2,076,463</u>
Accounts Payable	\$ 229,876	\$ 180,193
Accrued Expenses	281,157	201,049
Total Liabilities	<u>511,033</u>	<u>381,242</u>
Stockholders' Equity	<u>2,303,215</u>	<u>1,695,221</u>
	<u>\$ 2,814,248</u>	<u>\$ 2,076,463</u>



PharmChem, Inc.
Summary Statements of Operations
For The Twelve Months Ending December 31, 2015 and 2014

	2015 (Audited)	2014 (Audited)
Net Sales	\$ 3,233,777	\$ 2,522,857
Cost of Goods Sold	1,241,589	949,704
Gross Profit	1,992,188	1,573,153
Selling, General & Administrative Expenses	1,338,727	1,101,344
Operating Income	653,461	471,809
Dividend Income and Realized and Unrealized Loss on Securities, Net	(29,078)	(32,502)
Net Profit Before Taxes	624,383	439,307
Provision for Taxes	16,389	5,312
Net Income	<u>\$ 607,994</u>	<u>\$ 433,995</u>