Transcript of Sharps Compliance, Inc.
Second Quarter 2016 Earnings Conference Call
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Participants
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David Tusa – Chief Executive Officer and President
Diana Diaz – Vice President and Chief Financial Officer
Brandon Beaver – Senior Vice President of Sales

Analysts
Joe Munda – First Analysis
Kevin Steinke – Barrington Research
Brian Butler – Stifel
Craig Hoagland – Anderson Hoagland

Presentation

Operator
Greetings, and welcome to the Sharps Compliance Second Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. (Operator instructions.) Also as a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Mr. John Nesbett of IMS. Thank you. You may begin.

John Nesbett – Investor Relations, Institutional Marketing Services
Good morning, and thank you for calling in. On the call today, we have David Tusa, the company's President and Chief Executive Officer; Diana Diaz, Vice President and Chief Financial Officer; and Brandon Beaver, Senior VP of Sales.

David will review the company's business operations and growth strategies and Diana will review the financials. Brandon will discuss the company's sales initiatives and related activities. Immediately following their formal remarks, we will take questions from our call participants. If you are listening via webcast, please note that you have the ability to submit questions through the internet.

As you're aware, we may make some forward-looking statements during the formal presentation and in the question and answer portion of this teleconference. These statements apply to future events, which are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from where we are today. These factors are outlined in our earnings release, as well as in documents filed by the company with the SEC. These can be found on our website, or at sec.gov.

With that I will now turn the call over to David to begin the review and discussion. Go ahead, David.

David Tusa – Chief Executive Officer and President
Thanks, John. Good morning, everyone, and welcome to our second quarter fiscal year 2016 earnings call. The December 2015 quarter was highlighted by record customer billings of $10.5 million with growth in most of our

markets including Pharmaceutical Manufacturer, Professional, Assisted Living, and Home Healthcare. The one sector that lagged the December quarter was our Retail market, which is driven significantly by flu season related business.

As many of you have seen, the flu season and weather across the country in the fall of 2015 has been very mild. The flu season historically peaks in December, but this year's flu season has not yet peaked and some experts say the flu season may not peak until next month or even later. So, if you look historically, if you look at the calendar year 2014 flu shot season for us, we generated about $6 million, $6.1 million in customer billings. We had anticipated about $7 million for the calendar year '15, which is a 15% increase.

We believed 15% was reasonable in light of the historical annual increase from this business from about 23% to 36% over the last few years. But, because of the mild weather and the delay in the season, we generated only $5.2 million in the flu shot business in the calendar year '15, which is how we look at the flu shot season. That's an approximate $2 million shortfall from our internal budgets of about $7 million. So that gives you a dollar impact on the effect of the slowness of the flu shot season.

Now, moving forward. We made significant progress with our strategic initiatives in the December quarter. First, we broadened our route-based pick-up capabilities with an additional acquisition in the Northeast. Second, we advanced our relationship with the government sector with the execution of a blanket purchase agreement with the Veteran's Administration. We have begun to see the impact on revenue from our two recent acquisitions: Alpha Bio Med and Bio-Team Mobile. I believe we should begin to see the impact on the government-related revenue from the BPA with related orders as early as this week.

Gross margins were lower than what we had expected. We had two things happen. One, we had about $600,000 of revenue from a legacy pharmaceutical manufacturer patient support program. It's a split revenue model that doesn't have a lot of margin, or little to no margin upfront. The margin is generated on the backend side. That's a significant portion of revenue at low margin, so that reduced the overall gross margin.

We also had about $200,000 in additional operating cost related to the treatment facility in Texas. The good news is the majority of these additional expenditures are not expected to recur for somewhere between 15 and 36 months. A normalized margin without the impact of these two items would've been closer to 39%.

Let's review a bit more about the individual markets. Pharmaceutical Manufacturer billings grew 93% to $2.5 million in the second quarter, as we filled orders for new inventory builds related to four patient support programs. We expect to see continued strength from this segment and we anticipate launching two additional patient support programs for new drug therapies over the next three to four quarters.

Our Professional market grew 9% to $1.9 million in the second quarter as we continue to rollout sales and marketing initiatives around our multiple solution offerings: the Sharps Recovery Mailback System and our new route-based pick-up service. Our focus is on the small-to-medium quantity generator sector such as clinics, dentists, vets, surgery centers, and other healthcare professionals and facilities. For service in a recurring revenue-based model, we believe our comprehensive service offering with both the mailback system and the route-based pick-up offer our customers choices, cost savings, and operational efficiencies.

The government billings increased by about 61% for the quarter, and for the trailing 12 months we generated government billings of about $2.2 million. Growth was driven by both the TakeAway Envelopes and the MedSafe solution, both designed for the proper disposal of unused medications including controlled substances.

Now more about the blanket purchase agreement with the VA. As I mentioned earlier, we were advised that we're going to start receiving the orders related to that blanket purchase agreement this week. So, we will provide the envelopes to the VA healthcare facilities across the country. The BPA allows, it doesn't obligate, but it allows the VA to purchase up to $7 million per year of TakeAway Envelopes over a five-year agreement period. The BPA is structured as a base year plus four option years. There's no guarantee of volume and the BPA may be cancelled by either party with 30 days' written notice.

The TakeAway Envelopes meet all of the requirements of the DEA's new Secure and Responsible Drug Disposal Act for the proper and cost effective collection, transportation, and treatment of consumer dispensed unused medications including controlled substances. While we didn't see significant government orders in the December quarter, we do believe we should see an increase in the government sector as early as the March quarter.

Home Healthcare and Assisted Living billings increased 19% and 14% respectively. Home Healthcare billings increased due to the timing of distributor orders. Assisted Living billings benefited from an increased sales focus on this market, including the sale of our route-based pick-up service.

The Retail market billings actually decreased 1% to $3 million in the second quarter primarily due to the decrease of $700,000 in this flu shot business. It was partially offset by about $600,000 in sales of our TakeAway Envelopes to the Retail sector. Looking at the trailing 12 months, Retail market billings increased 8.6% to $8.5 million including a $1.2 million increase from sales of the TakeAway Envelopes.

So, despite the delay in the peak flu season, we remain confident that the retail market will continue to drive our long-term growth as customers increasingly go to alternative sites for flu shots and other immunizations.

In addition to driving organic growth and launching new products, we continue to explore additional acquisition opportunities that fit our strategic goals and focus on capturing recurring revenue from our core customer base of small-to-medium quantity generators.

In December 2015 we announced the acquisition of Bio-Team Mobile, which further enhances are route-based pick-up offerings and strengthens our presence in the Northeast. Additionally during the December quarter, we made excellent progress with our treatment facility and distribution warehouse in the Northeast, which we expect could be operational by as early as this summer.

Our unused medication solutions, including the TakeAway Medication Recovery System and the MedSafe, as well as our new route-based pick-up service, continue to gain traction and continue to attribute success in our inside and online sales channel, which grew by 12% in the second quarter and 19% for the fiscal year-to-date period.

Finally, we pride ourselves on the ongoing development of new value added service offerings designed to solve problems for our customers while saving them money. We're working on a couple of new exciting offerings that we believe could be launched in the calendar year of 2016.

And with that, I'll turn the call over to Brandon who will give you an update on our sales initiatives. Brandon?

Brandon Beaver – Senior Vice President of Sales
Thank you, David. As David mentioned, we saw solid results from the Pharmaceutical Manufacturer, Home Healthcare, Professional, Government, and Assisted Living markets this quarter. Retail was down, as already discussed, due to warmer weather in the US, which has delayed the peak of the flu season.

We are pleased to deliver significant growth in the Pharmaceutical Manufacturer segment through patient support program inventory builds. Our relationships in this market remain very strong because our partners recognize the value of our unique solution, which is not just a disposal solution for patients in the home setting, but also provides an opportunity for pharma branding and data generation related to patient behavior and medication adherence.

While we sometimes experience inconsistencies in the order patterns in this segment due to program timing, we're encouraged by the many opportunities we're seeing for pharma, including programs for new self-injectables, new drug indications, as well as higher patient counts.

Growth of 9% for the Professional market reflects our continued focus on educating the physicians, dentists, vets, and other healthcare providers who make up the small-to-medium quantity generator sector, on the financial and operational benefits and convenience of the Sharps Recovery System, as well as our new route-based pick-up service. This professional sector represents a recurring revenue model and once we illustrate the cost savings and ease of using our solutions, we increase our opportunity to capture these potential customers.

The addition of the route-based pick-up service provides our sales team with another value-added service, as well as an offering in addition to the mailback. Our sales team is well trained and qualified on both the mailback, as well as the route-based solutions. Offering service alternatives for our customers allows us to develop the best solutions that not only saves money for them, but also fits their operational needs.

Let's go over to our Assisted Living market. Our Assisted Living billings showed continued strength in the second quarter with 14% growth, which is the result of dedicating our resources to closing new customer deals, converting untapped opportunities. This also reflects the appeal of our new route-based pick-up service, which is very well suited for this market.

Our sales team is dedicated to driving customer awareness of Sharps' integrated and customizable portfolio of waste management solutions including medical with both the mailback and route-based pick-up, pharmaceutical, hazardous, and universe waste, and patient dispense unused medications.

As of today, our sales team consists of 5 field sales personnel, 15 inside sales personnel, and 6 sales support personnel, for a total team count of 26 employees. It's an experienced team focused on executing on new opportunities, onboarding new customers, and accelerating our closure rate.

With that, David, I'll turn it back to you.

David Tusa – Chief Executive Officer and President
Great. Thanks, Brandon, for the update. Now we'll have Diana cover the financial section.

Diana Diaz – Vice President and Chief Financial Officer
Thank you, David. During our second quarter, revenue grew 15% to $10 million as compared to $8.7 million in the second quarter of last year. During the second quarter, the GAAP adjustment, which is the difference between customer billings and GAAP revenue, had a larger than normal negative impact on revenue. The GAAP adjustment reflected larger deferrals related to a higher level of billings for the quarter, as well as deferral of significant prepaid amounts related to a Pharmaceutical Manufacturer patient support program.

Gross margin was 33% in the second quarter of fiscal 2016 compared to gross margin of 37% in the second quarter of fiscal 2015. Gross margin in the quarter was adversely impacted by about $600,000 in revenue from a legacy Pharmaceutical Manufacturer patient support program that has little or no upfront margin, as David described earlier, and by about $200,000 in additional operating costs related to the company's existing treatment facility, the majority of which are not expected to reoccur for 15 to 36 months. The normalized and expected gross margin for the quarter was 39%.

Selling, general, and administrative expense, or SG&A, increased to $2.6 million for the quarter and declined to 26% as a percentage of sales compared to second quarter of 2015. SG&A for the second quarter of fiscal 2016 included a $100,000 cost associated with our acquisition of Bio-Team Mobile in December of 2015. Without these acquisition-related costs, SG&A increased 4% compared to the second quarter of fiscal 2015. Exclusive of any potential acquisition-related cost, we expect SG&A to be about $2.5 to $2.6 million per quarter for the next three quarters.

The company reported operating income of $0.7 million in the second quarter, consistent with operating income in the second quarter of fiscal 2015. Sharps reported net income of $0.6 million, or $0.04 per basic and diluted share this quarter compared with net income of $0.7 million, or $0.05 per basic and diluted shares in the second quarter of fiscal 2015. EBITDA for the second quarter of fiscal 2016 was $0.9 million as compared to EBITDA of $1 million in the same quarter last year.

Now let's take a look at the highlights for the six months ended December 31, 2015. Revenue increased 14% to $17.9 million and customer billings increased 15% to $18.5 million. Pharmaceutical Manufacturer billings grew 40% of $3.8 million, primarily due to inventory builds for new programs. Last quarter we reported that we estimate revenue from new programs, including the two programs to be launched over the next three to four quarters, to reach a total of $4 million or more on an annual basis when fully rolled out. We are still on track to reach those revenue levels.

Home Healthcare billings increased 15% to $4 million in the first six months of fiscal 2016. Government billings increased 149% in the first six months to $0.7 million as compared to $0.4 million for the first half of fiscal 2015. This increase in government billings is largely due to increased orders for the company's new unused medication disposal solutions including the MedSafe solutions and TakeAway Medication Recovery System Envelope. Both of these solutions have been approved for purchase and used by federal government agencies.

Professional billings increased 13% to $3.6 million and Assisted Living billings increased 15% to $1 million.

The first half of fiscal 2016 gross margin was 35%. SG&A expense increased to $5.2 million in the first six months of 2016, an increase of 9% over the prior year period. SG&A for the first half of fiscal 2016 includes $0.2 million of acquisition-related costs associated with our acquisition of Alpha Bio Med in July 2015 and Bio-Team Mobile in December 2015. Without these acquisition-related costs, SG&A increased 6% compared to the first half of 2015 as a result of ongoing investment and sales and marketing initiatives.

The company reported operating income of $0.9 million for the first half of fiscal 2016, compared to operating income of $0.7 million in the same prior year period. The company reported EBITDA of $1.3 million in the first half of fiscal 2016 as compared to EBITDA of $1.1 million in the first half of fiscal 2015. Net income for the first six months of fiscal year 2016 was $0.8 million, or $0.05 per basic and diluted share, compared to net income of $0.7 million, or $0.04 per basic and diluted share, in the same prior year period.

Our balance sheet remains solid with $14.5 million of cash and cash equivalents as of December 31, 2015 and no debt. December 31, 2015 working capital, stockholders' equity, and total assets were $18.8 million, $24.6 million, and $31.7 million respectively. Inventory of $3.8 million at December 31, 2015 is higher than the balance at June 30, 2015 of $2.7 million. The increase in inventory is a direct reflection of growth in the business, as well as preparation for government envelope orders.

And with that, I'll turn the call back to David.

David Tusa – Chief Executive Officer and President

Great. Thanks, Diana. Just a couple of more comments before we turn it over to the Q&A. We continue to focus on the four major components of our growth strategy, which includes continuing to drive strong organic growth in all of our key markets, introducing new and value-added products and services, capitalizing on large government-related opportunities, and closing more acquisitions that complement our existing service offering and enable us to further focus on core recurring revenue from the small-to-medium quantity generator market.

In addition to executing on the broader goals, we are making excellent progress on the expansion of our infrastructure in the Northeast. It will include both a treatment facility and a distribution center warehouse. The Northeast is a strong and growing region for us and we believe the expansion, which we expect could be operational as early as the summer, will better position us to serve our customers and facilitate growth of our route-based service capabilities.

Our team here is laser focused on providing our customers, existing and new, with the most comprehensive and cost-saving waste management solutions while driving revenue and billing growth and of course profitability. We're executing well against our goals for strategic growth, and we look forward to updating you after the March 2016 quarter.

So with that, operator, let's open it up for questions.

Operator
(Operator instructions.) One moment please while we poll for questions. Our first question is from the line of Joe Munda from First Analysis. Please proceed with your question.

<Q>: Good morning, Dave, and Diana, and Brandon. Thanks for taking the questions.

David Tusa – Chief Executive Officer and President
You bet. Good morning.

<Q>: David, I want to start off on your prepared remarks; the company believed revenue was adversely impacted by about $2 million on the internal budget. Based on the commentary you just gave to us, let's say we have flu shot season peak this quarter and you start to see the government revenues that you expect, would it be safe to assume that $2 million pulls through to this quarter that was a shortfall this past quarter?

David Tusa – Chief Executive Officer and President
Joe, that's a good question. We don't know yet. We only know that there has been a delay in the season. Some of that could come in the March quarter; it may not. It's really too difficult to tell at this point. But that business for us has been solid a 20% to 30% increase in year, over many, many years. This is an unusual season. So we're hopeful that we could see some of that in the March quarter; we just don't have any visibility on that right now.

<Q>: Okay, and then on the gross margin front, the $600,000 in revenue that you recognize no margin from, the pharma support legacy program, is that going to—I guess you said that's backend load, as far as the margin, when it's realized. When can you expect to see the benefits from that legacy pharma program?

David Tusa – Chief Executive Officer and President
That will turn. That margin will be recognized within calendar year '16 as those units come back from the patients at home. We'll get that margin and it will be spread over the next four quarters.

<Q>: Okay. And then, I guess, a couple more here. The acquisitions that you did. Can you give us a sense of the contribution possibly on top line and the cost related to them that have been incurred in the quarter, if any?

David Tusa – Chief Executive Officer and President
Sure, go ahead, Diana.

Diana Diaz – Vice President and Chief Financial Officer
Sure. So, looking at December, which included three months for Alpha Bio Med and a half month for Bio-Team Mobile, our revenue exceeded our estimates for growth and our margins were above our expectations. The revenue for the quarter actually came in about 42% higher than historical revenue for these locations. So, we're feeling really good about this.

David Tusa – Chief Executive Officer and President
And what was that, about $220,000?

Diana Diaz – Vice President and Chief Financial Officer
Yes, $220,000.

David Tusa – Chief Executive Officer and President
Yes, $220,000 in revenue and of course we're just getting started and we're really pleased to see that what we set out to do is working, the acquisition of these companies and utilizing our marketing resources and integrating them into our company and driving growth. We've been very pleased so far, and it's early on. When we approach the next couple of quarters, we'll be able to get some more color and I'd expect to see significant growth rates in that business.

<Q>: Okay. My final question and then I'll hop back in the queue. David, in your prepared remarks you just talked about new product offerings possibly coming. Can you give us some sense of where or what segment that that would be a focus in as far as new product offerings are concerned?

David Tusa – Chief Executive Officer and President
It's probably a little bit too early to go into detail, but we are excited. A couple of new markets, they're mailback-related products, new products, and I'll just say they're designed to solve a problem for a significant sector out there in the healthcare world. We're good at solving problems and we're really good at developing mailbacks to solve problems. So we're working on a couple of new products and we're hopeful that they could potentially even impact 2016.

<Q>: Okay, thank you.

Operator
The next question comes from the line of Kevin Steinke from Barrington Research. Please proceed with your question.

<Q>: Good morning, everyone.

David Tusa – Chief Executive Officer and President
Good morning.

<Q>: It sounds like, obviously, you're optimistic about the Northeast region and that's a strong and growing region for you as you mentioned. Just wondering, in terms of the route-based capacity, do you feel like what you have in place now after these two acquisitions is sufficient for at least some period of time and you'll take some time to go into that route-based capacity? Or do you feel like you need to add more in the near-term to service the customer base you have right now?

David Tusa – Chief Executive Officer and President
It's a really interesting business and right now; we're serving five or six states up there.

Brandon Beaver – Senior Vice President of Sales
Five states.

David Tusa – Chief Executive Officer and President
Five states. We'll ultimately serve ten states in the Northeast. Really, there's just permitting that needs to be completed up there. But the way to expand the business is with the treatment facility up there, and we have the two existing acquisitions, but the way to expand that is to buy more trucks.

We think that with those two acquisitions, and maybe another one in the Northeast, but even with just those two, if we invest more in trucks and getting permits in additional states, then we'll ultimately be able to service up to ten states up in the Northeast, maybe even by the end of this calendar year. Having our treatment facility up in that area as well will be critical to making that is efficient as possible.

<Q>: Okay, that's very helpful. Wanted to also ask about the blanket purchase agreement with the VA. As I understood it, maybe initially even, with this agreement, the VA was still going to take a little time maybe to evaluate how extensively they wanted to roll out this program with you. I mean, it sounds like, have they decided to do it nationwide, or are they still in an evaluation phase of how extensive this program is going to be?

David Tusa – Chief Executive Officer and President
The BPA came with a very complex statement of work. It's not just a traditional program, put an envelope in a box and send it to the VA; it's pretty comprehensive. That statement of work contemplates a nationwide program. What they've been doing since November, it was ordered in November, until now, is working internally on the ordering process and different protocols that need to be put in place between them and us. That's now been completed.

We were told we're going to start receiving the actual orders against the BPA this week. So the way you think about that is the orders will come in, and there's probably 100 to 120 different VA facilities that we'll be shipping directly to. So they can get those envelopes to the veterans as efficiently as possible and as soon as possible. We'll see.

Let's get this March quarter past us and let's see what kind of orders come in and the volume. I think we'll have a lot better visibility after the March quarter on expectations for the rest of the year. We've been very pleased with them, we work well with them, we've got a great relationship with them. We're excited about shipping these envelopes out to those multiple locations.

<Q>: Okay, great. You mentioned 100 to 120 facilities, I guess there potentially could be an opportunity to ship to a greater number of facilities. Is that correct?

David Tusa – Chief Executive Officer and President
I think these are the ones that they've identified that would be the best to most efficiently get the envelopes to the veterans. This is just a channel that's being used. We'd love them to order, we can't guarantee it, but it would be great if they order $7 million dollars' worth of the envelopes. They best know how to distribute them to get the maximum impact.

<Q>: Okay, okay. That makes sense. Diana, just a quick question here on the tax in the quarter. Every few quarters you have a little bit of a spike-up in the income tax expense. I don't know if there's any, what the explanation is for that or what we should think about for the rest of the year.

Diana Diaz – Vice President and Chief Financial Officer
We're reporting at our effective tax rate that we had at the end of last year, so it's just around 8%. It's primarily state income tax, which we owe even though we're in NOL position where we're releasing the valuation allowance against taxable income. I think probably that level until our NOL are used up would be a decent estimate.

<Q>: Okay, fair enough. That's all I have for now. Thanks for taking my questions.

David Tusa – Chief Executive Officer and President
You bet. Thanks, Kevin.

Operator
(Operator instructions.) Our next question comes from the line of Brian Butler from Stifel. Please proceed with your question.

<Q>: Good morning. Thank you for taking my questions.

David Tusa – Chief Executive Officer and President
Good morning. How are you doing?

<Q>: Doing well. How about yourself?

David Tusa – Chief Executive Officer and President
I'm doing great.

<Q>: Let's start just back on the retail side on the flu shots. It looks like the flu doses dispensed to date are kind of on par with where they were last year based on the CDC's reporting. First half '15 versus your first half '16 seems like orders for disposal are definitely lower. Can that be made up in the third quarter '16-- that kind of shortfall?

David Tusa – Chief Executive Officer and President
It's a great question, Brian, we're trying to figure that out. We have the product available to facilitate whatever spillover that may occur. I think it's going to just have to do a lot with the severity of the flu shot season and whether folks get back out there and start getting flu shots. You really didn't see much in the media this year about reminding people to get their flu shots and about the dangers of the flu.

I guess there's got be an event. There's got to be a significant increase in flu or there's got to be something that's got to happen to be able to drive people to get more flu shots. To be honest with you, we really just don't have a lot of visibility on that. Right now we only know if we start to receive more orders from the customers.

<Q>: So in the first month of the third quarter for you guys, you haven't seen this trend really change at all. You're still seeing what you saw in the second quarter continue into January here.

David Tusa – Chief Executive Officer and President
That's correct.

<Q>: Okay. Short of those flu shots coming back is the growth rate for retail really more in that 10% to 15% range versus the 15% to 20% that you guys target?

David Tusa – Chief Executive Officer and President

No, I think this has been a real anomaly. I've been here a long time at this company, I've seen a lot of flu shot seasons and it appears to me to be an anomaly. I think I've only seen this one time before where there was a delay in the flu shot or it was a mild flu shot season. No, I think it's an anomaly and I think ultimately it will get back on track. I can't make any guarantees or promises, but I do think this is an anomaly.

<Q>: Okay. Then on the government side, clearly the orders were down sequentially from first quarter into the second quarter. Is any of that being driven by the fact that the new agreement was out there and there was, were you getting pushback? Or not pushback, maybe just communication that they were holding off until the BPA was kind of figured out?

David Tusa – Chief Executive Officer and President
Yeah, that's right. We got the orders in the March and in the June quarters, and then they were working towards the BPA, so they held off on September and December orders until the BPA was one, completed, and two, that they had their internal ordering processes in place to begin to order the envelopes. That's happening this week so we should see the beginning of the orders this week. But yes, the lag in the September and December quarter was slow because they were waiting on the contract.

<Q>: And that $2.2 million of trailing 12-month revenues, that should be the base and everything going forward, we should just be seeing upside from that as these orders kind of flow-through.

David Tusa – Chief Executive Officer and President
I don't know, I'm not going to guess. What I'd really like to see is the orders coming in and I do know they like the TakeAway Envelope. They signed a contract on the TakeAway Envelope for as much a $7 million a year. I also know they like the MedSafe and the MedSafe is included in that number as well. We've done a pretty good job of getting the MedSafe out into the VA hospitals, the VA facilities, and we understand they have an interest in more purchases of the MedSafe.

So what I'd like to see is I'd like to see strong orders for the TakeAway Envelope and for the MedSafe. I can't make any promises or guarantees, but I think that the government sector, now with the contract in place and now that we've got many MedSafes out there, that has the opportunity to grow to a higher level.

<Q>: From the government's perspective, who makes these decisions? Is this being made by individuals at each of the 100 facilities that you're talking with or is this more centralized?

David Tusa – Chief Executive Officer and President
It's a centralized decision-making process.

<Q>: This is someone, I'm guessing not more than a couple people in the VA that decide that this is a number of mailback envelopes that we want to be sent out to everybody.

David Tusa – Chief Executive Officer and President
That's correct.

<Q>: And that funding, is that funding also then at a national level or is it funded out of each of the individual facilities?

David Tusa – Chief Executive Officer and President
It's funding at a national level.

<Q>: Okay. Let's see, I have a couple more. On Pharmaceutical, the $3 million to $4 million of annualized revenues come in, that's from the new program that you're going to put out over the next three to four quarters, is that correct?

Diana Diaz – Vice President and Chief Financial Officer
It includes revenue from new programs that have already been in place, plus the two new ones that are going to come on.

<Q>: Okay, so when I think about the trailing 12 revenues, Pharmaceuticals being $5.9 million, is that $3 million to $4 million on top of that? Or is that, you're going to see a pullback in the next quarter as the inventory builds slowdown and rise and fall with the new orders?

Diana Diaz – Vice President and Chief Financial Officer
The historical revenue includes over $2 million from new programs.

David Tusa – Chief Executive Officer and President
So you got another $2 million?

Diana Diaz – Vice President and Chief Financial Officer
Yes, we have another $2 million to go.

<Q>: Okay, so when I think about it on an LTM basis there's another $2 million on top of the $5.9 million that's out there, that's the right way? Okay. And Professional, how much of the Professional of the growth you saw in the second quarter was from acquisition? Was that something you can talk about?

David Tusa – Chief Executive Officer and President
It's actually spread between a couple of different markets.

Diana Diaz – Vice President and Chief Financial Officer
Right, it's spread over Professional and Assisted Living, but it was maybe $100,000.

David Tusa – Chief Executive Officer and President
It was $220,000 total, which is probably split between Assisted Living and the Professional market.

<Q>: I guess what I was trying to get at was the Professional growth was like 9% year-over-year in the quarter and some of that, I'm guessing, is from acquisitions so it just seems like the organic growth in Professional seems extremely slow in the second quarter. Is there something fundamentally that's changing there or is this just kind of getting this acquisition sorted out?

Diana Diaz – Vice President and Chief Financial Officer
There's a component of the Professional market that's distributor-related. We did see a reduction in distributor orders during the quarter. It was apparent for the year-to-date period, but it was more apparent in the December quarter.

David Tusa – Chief Executive Officer and President
These distributors that she's mentioning are ones that traditionally provide our systems for the flu business. There is a portion in the Professional that was negatively impacted by the flu as well. So when you take that out—what is the number, Diana, when you normalized and took that impact out?

Diana Diaz – Vice President and Chief Financial Officer

It was more like an 18% growth.

David Tusa – Chief Executive Officer and President
Right, so you take out the impact of flu and distributors it's closer to 18%, which it should be. We strive to have it even higher than that and hope to see it even higher than that. Yes, that provided for a difficult comp.

<Q>: Okay, that's very helpful. On the cost side, what drives the cycle of that 15 to 36 months of the $200,000 of the operational stuff?

Diana Diaz – Vice President and Chief Financial Officer
Right, so a portion of the treatment facility expenses were related to our annual testing, our annual stack testing, which was successful this year and it allows us to wait another three years before another stack test. That's a big part of that component and there were some repairs and maintenance that would not have to recur for at least 15 months.

<Q>: Okay. Last one on cost here is when you have the new facility finally up and running, is that going to be a big cost-saver, and what's the right way to think about that? Or is that just simply, it's not going have an impact on cost and it's really just a help to drive sales?

David Tusa – Chief Executive Officer and President
Well hopefully it's going to do both. The distribution side of it is going to help reduce cost because it's going to lower our cost in distributing products, our mailback products, to customers out there in the Northeast and probably the Midwest so it will save there. It will also save, in a sense, because the business we're doing right now, our route-based businesses, are using third-party treatment facilities to process the waste. When we do it ourselves, it will be at a lower cost so we'll save money there as well.

It's also the opportunity to generate more revenue because in addition to the growing business the facility will be big enough that we'll have the opportunity to actually process third-party waste for haulers and others in that area. That has the opportunity to generate revenue. But all-in-all, we think it's going to be very important to driving growth in the revenue, having control of our destiny by having our own facility up there as well as generating cost savings.

<Q>: Any ability to make some forecast on the magnitude? Is this a 10 to 15 basis points savings on cost or is it really more a couple hundred basis points?

David Tusa – Chief Executive Officer and President
I'll tell you what, we'll save that one for when we announce that we've secured all the permits and we're fully operational. We'll have a lot better idea on those numbers and we'll be able to share it with you at that time.

<Q>: Alright, well thank you very much, very helpful. Thank you.

David Tusa – Chief Executive Officer and President
Alright. Thanks, Brian.

Operator
Our next question comes from the line of Joe Munda from First Analysis. Please proceed with your question. I'm sorry, Joe, are you there?

<Q>: Yes, I'm sorry. I was on mute. Just a few quick follow-ups here. Brandon, I missed the sales force breakout. Can you give us those numbers again? Inside sales versus direct reps?

Brandon Beaver – Senior Vice President of Sales
Sure. As of today, it's 5 field sales, 15 inside sales as well as 6 sales support personnel, so a total of 26. Joe, in the last 24 months, we've seen this just about double. We're very excited. The trend is moving significantly, especially with our inside sales team, as we continue to be able to offer route-based pickup as well as our mailbacks.

<Q>: Okay. To Diana's comment about SG&A $2.5 million to $2.6 million for the next couple quarters here, are we assuming that you guys are not going to continue to hire any more reps or are you full at the moment as far as hiring goes?

Brandon Beaver – Senior Vice President of Sales
I'll answer that, Joe. I would say no. We'll certainly evaluate that. I'm looking at that weekly, but I would say as we continue to look at the growth of the inside sales team members and they continue to get up to speed, we're looking at hiring a number of bodies in the next couple of quarters. We're not stopping in that sense.

Diana Diaz – Vice President and Chief Financial Officer
And that growth is contemplated in our budget and our estimates of the SG&A going forward.

<Q>: Okay, now as far as acquiring, let's say another business, would you acquire another business with reps or is that an opportunity there or you continue to prefer to do it on your own?

Brandon Beaver – Senior Vice President of Sales
Joe, typically at least when we go after haulers, normally they have a very low number of employees within these organizations, mostly operators, drivers, things like that, and so they really don't have a sales function other than just traditional marketing of websites. So we take a lot of that on, take some of that burden on and do that from Houston here. We look at all options; there could be a hauler out there or a hauler or treatment facility that does have some sales personnel and we'd look at it on a case-by-case basis.

<Q>: Okay. That leads me to assume that possibly inside sales is where you're going to add bodies, right, if that's the MO.

Brandon Beaver – Senior Vice President of Sales
I would say yes to that.

David Tusa – Chief Executive Officer and President
It's been really effective. I think Brandon and his team have done a great job in training the inside sales folks to be able to quickly spec out an opportunity and offer the right solution that works best for them and saves them the most money. You only have to ask four or five questions and you can figure out pretty quickly if it's a pickup or it's a mailback or if it's a combination.

We've been really impressed with the ability of those folks to be able to do that. When you want to go out and you want to hire people you just can't go out and say, "Let's just go hire a bunch of people." You've got to really bring in qualified folks that can deal with multiple offerings and that can close these deals.

We're very excited about that initiative and we think that the inside and online sales channel was, we break that out as well and it was strong. For the year-to-date period, the inside and online sales channel was up almost 19%. That's good because those smaller deals, higher margin deals are ones where we're seeing significant growth.

<Q>: Okay, that's helpful. My final question is, David, you talked about in your prepared remarks TakeAway Envelopes in the retail setting, that seems to be new to me. Can you give us a little bit of color there? I actually saw the envelopes at a CVS, so.

David Tusa – Chief Executive Officer and President
Right, we sell our envelopes in the retail section. We've sold them for years, but before it was the old envelope that didn't accept controls. But that was an order from a major retailer, right? Two major retailers that we received envelope orders from for the new envelope, the one that accepts the control substances. That's another channel for the envelopes in addition to the government business is the retail sector.

<Q>: Is the controlled substances envelope now in the retail setting?

David Tusa – Chief Executive Officer and President
Yes.

<Q>: Okay. Okay, thank you.

Operator
Our next question comes from the line of Craig Hoagland from Anderson Hoagland. Please proceed with your question.

<Q>: Hi, just one. The Home Health sector seems to have stepped up nicely from maybe a $7 million annual run rate to something closer to $8 million. You mentioned that you had some good distributor orders in the quarter. My question is, do you think that your efforts to grow share there are paying off or is this really just bumpiness that we're seeing so far this year?

Brandon Beaver – Senior Vice President of Sales
I would say we definitely had some decent orders from our distributors. Do we expect to see some of those going forward? Certainly, hopefully we keep up with the trends. As David's mentioned over a number of quarters, this has become a very difficult segment of our business; it's very fragmented. I think we've done a very good job of holding the business over the number of years. As you all know, we started in this business in the Home Health side.

Do I think that there's a significant growth opportunity here? I think it's definitely got some opportunity, but right now we're going to continue going with what we've got with our distributor model.

<Q>: Okay, thank you.

Operator
It appears there are no further questions in the queue. Management, would you like to make any closing remarks?

David Tusa – Chief Executive Officer and President
Thank you, everyone, for participating in the call. We look forward to speaking with you next quarter. Everyone, have a great day. Thanks.