Sharps Compliance Corporation
Fourth Quarter Fiscal 2009 Earnings Teleconference & Webcast
August 10, 2009

Operator: Greetings, and welcome to the Sharps Compliance Corporation fourth quarter fiscal 2009 earnings conference call. It is now my pleasure to introduce your host, Mrs. Deborah Pawlowski, Investors Relations for Sharps Compliance Corporation. Thank you, Mrs. Pawlowski, you may begin.

Deborah Pawlowski: Thank you, Shay, and good morning, everyone. We appreciate your participation in our fourth quarter and fiscal year 2009 earnings conference call. You should have a copy of the news release detailing Sharp's financial results that was released earlier this morning. If you do not have it, you may obtain a copy from the Company's website at www.*sharpsinc.com*.

With me here today are Sharp's Chairman and CEO, Dr. Burton Kunik, and Executive Vice President and Chief Financial Officer, David Tusa. Burt and David will provide their planned comments, and then we will open it up for questions. If you are listening via the webcast, you also have the ability to submit questions online.

As you are aware, we may make forward-looking statements during both the call and in the following question-and-answer session. These forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties, as well as other factors that could cause the actual results to differ materially from what we discuss here. These risks and uncertainties are available for you in the press release itself, as well as with the Company's filings with the Securities and Exchange Commission at www.sec.gov.

So with that, let me turn the call over to Dr. Kunik to begin the review and discussion.

Dr. Burton Kunik: Thank you, Debbie, and welcome, everyone, to our fiscal year 2009 fourth quarter and year-end teleconference call. Fiscal year 2009 was an exceptional year for Sharps Compliance. We announced, successfully launched, and continued to execute on our U.S. Government contract. We recognized $3.2 million in revenue from the contract in the fourth quarter and $6.1 million since it was launched. The product build-out portion of the contract is expected to be complete by the end of the calendar year 2009, at which time the current contract will move into a maintenance phase.

We are actively marketing the Sharps Medical Waste Management System™ to federal, state, and local government agencies, as well as corporations and industrial companies that have emergency preparedness programs in place. We believe the value we provide is readily recognizable, giving us the confidence in our ability to secure additional major contracts. David will go more into detail, including our revenue expectations relating to this contract.

We added our fifth and sixth pharmaceutical manufacturers Patient Support Compliance Programs in fiscal 2009, as well as renewed the Company's first pharmaceutical manufacturers Vendor-Managed Inventory program, which was originally awarded in March of 2006. We believe the pharmaceutical market is still an untapped opportunity, and we're just beginning to see the potential growth we can ultimately realize.

In May of this year, we moved from Over-the-Counter Bulletin Board to the NASDAQ Capital Market and changed our ticker symbol to SMED. Our strong fundamentals and consistent growth will lead us to obtain the required financial and liquidity benchmark for listing. We believe achieving a NASDAQ Capital Market listing will provide greater visibility and liquidity for our stocks. As an added note, Sharps Compliance was added to the Russell Microcap Index at the end of June this year.

In the latter part of 2008, we launched RxTakeAway™, a new line of products specifically designed to safely dispose of unused medications. It is estimated that 200 million or more pounds-per-year of unused pharmaceuticals could be potentially polluting our environment and placing children and teenagers at risk for accidental poisoning. The RxTakeAway™ is designed for retail or mail order pharmacies, alternate care facilities, community programs, and individual consumers. They consist of a variety of sizes of containers and include return packaging with prepaid postage to our incineration facility. Interest in our disposable solution for unused medications is very high, and we expect to recognize notable sales of the RxTakeAway™ products during fiscal year 2010.

Briefly looking at our fourth quarter results, revenue jumped more than 140% over last year's fourth quarter, driven by our government contract and increased sales from our core business, particularly our pharmaceutical, home healthcare, and retail markets. Excluding the government contract, core revenue grew approximately 30% over the prior year's fourth quarter.

The launch of our latest Patient Support Compliance Program for a major pharmaceutical manufacturer and the success we've had expanding our distributor network in the home infusion market have led to increased revenue in our pharmaceutical and home healthcare markets, respectively. We are already experiencing orders from our retail market customers in advance of what is expected to be a strong flu shot season with the H1N1 virus. There will be an increase in the overall number of flu shots administered this year as citizens receive more than one flu shot to be vaccinated for both the seasonal flu and H1N1 flu. Our customers are telling us they expect more of these shots to be administered outside of the hospital and doctor's office setting, and as a result, we expect our core business to post solid sales and continue to grow.

With that overview, I'll turn the call over to David for a review of our financial performance and a more detailed description of the earnings release.

David Tusa: Thank you, Burt, and good morning, everyone. Thank you for participating in the call.

As you see from a review of the earnings release, our fourth quarter revenue of $6.7 million was 141% higher than the $2.8 million in revenue for the prior year period. The increase was driven by the $3.1 million in revenue related to the sale of our Sharps Medical Waste Management System™ to an agency of the United

States Government under our recently announced contract. The fourth quarter was also positively affected by about $430,000 in billings related to the Company's launch of the latest pharmaceutical manufacturer patient support compliance program. A strong start to the flu shot business also positively impacted the month of June, as you see by the strong retail market numbers.

There are also about $260,000 of orders in the retail market line added that are attributable to a large order to support community programs where patients can receive their Sharps Disposal by Mail System® through their local pharmacy. We were also pleased to see an increase on the healthcare market billings that positively impacted our fourth quarter numbers. This was a result of the successful expansion of our distributor network in that market.

In the fourth quarter, the billings were down a bit in the commercial market because in the prior year's period, we had a number of one-time orders that weren't in the current year's period. The billings in the agricultural market, on first glance, look low when compared with the prior year's period; that was a timing issue. We had a large order of about $85,000 in July of 2009. If it had been included in the June numbers, the comparison would have been much improved.

For the fiscal year ending June 30, 2009, revenue increased by almost 60% to $20.3 million. This is compared with the prior year's fiscal year revenue of $12.8 million. The increase in revenue for the fiscal year period was driven by approximately $6 million in billings related to the U.S. Government contract, an $809,000 increase in retail market billings driven by the flu shot business, as well as supporting community programs; and about $668,000 in increased billings in the pharmaceutical manufacturer market, where the Sharps Disposal by Mail System® is used to support patient compliance programs.

We were very pleased in the fourth quarter to see gross margin remaining very strong at 57%. This is versus 34% for the prior year's fourth quarter and gross margin of 51.5% for fiscal year 2009, compared with 40% for fiscal year 2008. The increase in gross margin is directly attributable to the significant operating leverage inherent in our business, as revenue grows at a rate well in excess of the cost of our expanded infrastructure. We also expect gross margin to be at or above these levels for the first quarter of fiscal year 2010, which ends September 30, 2009.

SG&A was about $2 million for the fourth quarter. This was up about $800,000 over the prior year's period, and there were a few items that caused that increase in the SG&A. We had a management incentive compensation accrual of $329,000 that was reflected in the fourth quarter. We also had increased sales in marketing, non-cash 123R compensation expense, which is higher than the prior year, and of course, the NASDAQ listing and related fees.

The incentive compensation was recorded all in the fourth quarter because there were a number of discretionary items that were part of the plan. Going forward, in fiscal year 2010, we expect to report quarterly accruals so we won't have a charge in the fourth quarter like we did this past year. The 123R was very high in the fourth quarter as well. We had some stock options with the vesting being driven by the stock price instead of the traditional three-year vesting. With the stock price's recent performance, that would be the vesting, and of course, the expense was accelerated into the fourth quarter.

For the fiscal year, SG&A was $6.1 million, which was $1.3 million, or 27%, higher than the prior year. The increase was related to the items that I spoke to for the fourth quarter, as well as about $200,000 in compensation and living expenses associated with a former officer in the Company that we had in fiscal year 2009 that we didn't have in the prior year's period.

Going forward into fiscal year 2010, we are expecting the SG&A to be in the range of $1.7 to $1.8 million per quarter. Any exceptions to this would be related to targeted sales and marketing opportunities.

As previously reported in April, we had a special charge of $512,000, or $0.02 per share, recorded in the fourth quarter. This was related to the April 2009 departure of a former officer. It's important to note that about $300,000 of that $512,000 is non-cash expense associated with acceleration of restricted stock.

Operating income for the fourth quarter was $1.1 million, or 16.5% of revenue. This was versus an operating loss of about $500,000 for the prior year's period. Excluding the $512,000 special charge and the $329,000 incentive comp accrual, the operating margin for the fourth quarter was about 30%. That's a very important number to us not only historically, but also going forward. That was consistent with the operating margin we generated for the sequential quarter, March 31, 2009. Operating margins for the first quarter of fiscal year 2010, which ends September 30, 2009, are expected to be in excess of 40%.

For the fiscal year ended June 30, 2009, the Company generated income of $3.5 million, or 17.1%, of revenue. This was compared with zero operating income for the prior year's period. The significant expansion in the operating margin is due to the fact that SG&A is increasing at a much lower rate than the revenue in the gross profit generated by the Company.

Net income of about $700,000, or $0.05 a share for the fourth quarter, compared with a loss of $0.04 for the prior year's period. Net income of $4.2 million, or $0.30 per diluted share, for the fiscal year 2009 compared with net income of about $81,000, or $0.01 of diluted share for the prior year's fiscal year period. The substantial growth in net income was driven by the significant operating and financial performance that we experienced in fiscal year 2009. Additionally, the fiscal year 2009 income was positively impacted by $1.8 million, or 0.13 per diluted share credit that we took related to income tax benefits.

The balance sheet is very strong; stronger than ever. At June 30th, we have $4.8 million in cash, total assets of about $15 million, and equity approaching $10 million, all of this with zero debt.

As most of you are aware, our government contract is valued at $40 million, $28.5 million of which is expected to be earned over the first contract year. That is the year ending January 31, 2010. The remaining $11.5 million is expected to be earned over the following four contract year periods as maintenance. That means, for the first contract year which will be completed by the end of this calendar year, we would have recognized $28.5 million on the contract. So far, we've recognized about $6 million, $3 million in each of the third and the fourth quarters of 2009. We expect to recognize an additional $11.5 million from this government contract for the quarter ended September 30, 2009, and about $11 million of revenue in the quarter ended December 31, 2009.

As I mentioned to many of you the government contract that we have is a sensitive contract. We're not allowed to disclose the name of the agency, and we request that you respect that confidentiality later when we take your calls.

Looking forward, as Burt mentioned, we expect a very strong first quarter fiscal year 2010 when considering the expected U.S. Government contract billings coupled with what is shaping up to be an exceptionally strong flu shot season in light of the H1N1 concerns. As many of you are aware, we're the leading provider of cost-effective medical waste solutions for the disposal of syringes used in the retail setting to administer flu shots.

To give you an idea of the strength of the flu shot season, not only did we see early billings in the month of June 2009 for the flu shot season, June of 2009, that the first quarter of fiscal year 2010, which is the quarter ended September 30th, that for the month of July alone, we had about $800,000 in billings and orders for the flu shot business. And that $800,000 for the month of July 2009, was equal to the entire amount of the flu shot business for the quarter ended September 30th of 2008. So it's starting out very strong, and again, consistent with the concerns over H1N1.

In addition to the expected strength of the flu shot business for the quarter ended September 30, 2009, we anticipate that the flu shot business will be strong through the December quarter. As many of you know, the only seasonal part to our business is the flu shot business, and it positively impacts the September quarter. It looks as if the flu shot season is going to last through December 31st, as our government officials are advising patients of the importance of receiving not only your standard flu shot but also advising that you receive more than one, and maybe even two of the H1N1 shots. Those vaccines are scheduled to be available in the October/November timeframe.

As discussed with many of you, our business model is one of significant operating leverage. You saw that in the third and fourth quarter of 2009, and you'll see even stronger operating leverage in the first quarter of fiscal year 2010, which ends September of 2009.

In anticipation of the growth, not only in the government sector, but also throughout our business, we began building the Company infrastructure during fiscal year 2008. This was done in order to effectively facilitate the growth and are now seeing a positive impact to this expansion on our operating and financial performance, as well as our ability to quickly meet the needs of our customers.

We're ahead of schedule on the U.S. Government contract. We're very pleased. Our customer is very pleased. We're also involved with a number of key sales initiatives. We have personnel focused on additional federal and state sales opportunities for the Medical Waste Management System™, as well as commercial opportunities where our Medical Waste Management System™ is seen to be a good fit for large corporation emergency preparedness programs. We're focused on additional sales of the Medical Waste Management System™ and believe that we could see a positive impact from that in the second half of fiscal year 2010.

With each passing quarter, it's very, very evident that we're filling a need in the marketplace with a cost-effective and comprehensive solution to medical waste disposal outside the hospital setting. I'll be back on the road next week doing the Midwest circuit, Minneapolis, Milwaukee, and Chicago. I look forward to visiting with a number of you on the road.

With that, Operator, we can turn it over to question-and-answer.

Operator: Thank you. We do have a question coming from Tom Szulist from no Limits IR, LLC.

Tom Szulist: Hi, gentlemen. Excellent quarter. Just had a couple of questions. I saw Waste Management and your program were kind of going their separate ways. Could you explain a little bit about what's taking place there?

Dr. Burton Kunik: Yes. We elected not to continue with this marketing agreement. It was an arrangement that we started that never generated very much revenue at all. At this point, we feel we can do much better just in our direct sales and internet marketing, on our own. We're not losing any of the customers we had from before. So, it is really a non-event for us.

Tom Szulist: It seems like such a lucrative area of the business. Are you seeing any type of competition starting to become any factor in your marketing plan at all?

Dr. Burton Kunik: Well right now, we see people looking at it. But, I've always had an attitude that if we can manage to be the leader in the marketplace, that competition will make us look better and help us grow our business. So right now, that's pretty much the position I think we're in.

Tom Szulist:. Great business model. I love what you guys are doing. Keep up the good work. Thanks.

Operator: Our next question is coming from George Walsh from Gilford Securities.

George Walsh: Good morning. Could you talk a little bit about the government market in terms of the difference between the national and state government markets and what your potentials are there?

Dr. Burton Kunik: Yes. Well, first of all, you already know we identified a large, unmet need in the emergency preparedness programs for the federal, state or local government markets, or even commercial accounts. The unmet need was managing the disposal after an event took place. We're currently in an excellent position with all the services and facilities that we have in place right now to manage any additional business for that, and we are actively involved in pursuing many different additional accounts, for government or large industrial accounts. There's definitely an unmet need, and we hope to capitalize on that.

George Walsh: And how does that work for a marketing organization for your service? Do you go into each of the 50 states, or do you concentrate on certain states as opposed to others?

Dr. Burton Kunik: Let me just brag about it. I'd say we have the best sales team for government that you could find in the country. These people know everybody, and they're going to the people they find have the most pressing needs. We're working on state, federal, and local levels and are just beginning to work in the industrial side of it. So we have excellent people who pick where they think the low-hanging fruit is to move forward, and it's looking good.

George Walsh: And could you also describe the Rx product? Are there regulatory pushes that would help this market for you, and is it something that the pharmaceutical chains would have an interest in?

Dr. Burton Kunik: This side has taken a leg in the market of itself in the government agencies. It's a very environmental issue, and it's a very large issue for the number of kids, teens or others, who are getting overdosed on medications that they are getting out of parents' and grandparents' cabinets. The numbers are really huge. When you think about the volume of prescriptions that go unused, these are numbers we never thought about before we got into this market. The numbers go up to 30% to 50% of all prescriptions given are never taken. Now that has become the main place that teenagers are going to get their highs. They're giving up some of the cocaine and marijuana and going for the unused prescriptions. It's a big issue in many federal and state agencies as well as environmental groups to try to address this. They're seeing changes in fish in the streams from people flushing these things down the toilets.

I think we currently have the best solution in the marketplace, and we're getting a lot of people to look at it and starting to take advantage of it. The unanswered piece at the moment, to have a totally sustainable program, is who is going to pay for it? That gets down to where is the manufacturer is going to play a role, and what role is everybody else going to play? Right now, we've got many opportunities with different scenarios of who is paying for it, so it's just the beginning of a very large growth opportunity.

George Walsh: Is it something that the pharmaceutical companies or the distributors would want to get ahead of the curve? And would the idea be that when you pick up your prescription, you get your service somehow with it, a package that goes with it? And to take that step a bit further, could that be a packaging issue where some, let's say like a Cardinal Health which does a lot of packaging for the majors, that you'd be working in conjunction with a company like that?

Dr. Burton Kunik: Well, it could be that, or it could be the manufacturer providing it through the pharmacy while it's being dispensed. Whether it gets packaged prior to getting to the pharmacy or whether it gets put together at the pharmacy when it's being dispensed, you're right on track there.

Over the long term, I think people will get an envelope with their first prescription. So many times, the first prescriptions turn out to be the ones that people say didn't work or creates problems for them, and they're left sitting there with 90 days' worth of pills. This would be a perfect way to provide a solution for them. We do have some pharmaceutical distribution centers working with us relative to that program.

Operator: Thank you. At this time, we have no further questions. I'd like to turn the call back over to Mr. Kunik for any closing comments.

Dr. Burton Kunik: Thank you, Shay. We are very pleased with our fourth quarter fiscal year 2009 results and expect that momentum to continue into the start of fiscal year 2010 with a very strong first quarter. We are aggressively pursuing additional opportunities to implement our Medical Waste Management System™ for other government agencies and industries, as well as our excellent offering for pharmaceutical manufacturers. In addition, we are expanding our sales approach to include telesales in an effort to educate prospective customers on the Sharps Disposal by Mail System® option and the potential savings of as much as 50% over the traditional pickup service.

Looking forward, sales are projected to increase significantly in our upcoming first quarter of fiscal year 2010, driven by the U.S. Government contract and an expanded flu shot season. We believe revenue will continue to increase at a greater rate than fixed costs, allowing gross margin to exceed 50% and also result in very strong operating margins.

Once again, thank you for joining us today on our fiscal year 2009 fourth quarter and year end earnings teleconference call.