Sharps Compliance Corporation
Second Quarter Fiscal 2010 Earnings
Teleconference and Webcast
February 4, 2010

Operator: Greetings, and welcome to the Sharps Compliance Corporation second quarter fiscal 2010 financial results teleconference. It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, Investor Relations for Sharps Compliance Corporation. Thank you, Ms. Pawlowski, you may begin.

Deborah Pawlowski: Thank you, Christine, and good morning, everyone. We appreciate your participation in our second quarter fiscal year 2010 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 on the call are Sharps' 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 via the Internet.

As you are aware, we may make forward-looking statements both during 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.

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 second quarter of fiscal year 2010 earnings teleconference call. This was another strong quarter for us as we benefited from the expanded flu shot season, which was augmented by the broader awareness and concern over the flu and H1N1 vaccinations. The quarter's results also included the completion of the product build-out phase of our first major U.S. Government contract. Strong revenue and volume enabled us to realize the leverage inherent in our business, resulting in solid gross and operating margins.

I am happy to report that in our core business, which excludes the Government market, billings increased 27% over the prior year's second quarter. Driving that growth was a result of our being the dominant provider of disposal solutions for the pharmacy and retail clinic markets. As such, we've benefited from their success, providing flu and H1N1 shots. Also, contributing our core business growth was the almost 20% increase in professional market billings in the recent quarter as our new targeted marketing strategy has been effective. As a result, we're adding staff to our outbound calling group and recently launched a new customer incentive program called Sharps Advantage. David will provide more detail around the program and its success.

The $28.5 million product build-out phase for the Government contract was completed, resulting in $11.5 million in sales in our second quarter. The contract now moves into a maintenance phase. We've been awarded the first option year, valued at approximately $1.6 million, which is expected to be realized from February 1, 2010 through January 31, 2011. The remaining three option years are expected to be approximately $3 million per year. We're actively in discussions with the agency regarding the expansion of the program and the inclusion of additional disposal solutions to the program.

An important event for us in December 2009 was our being awarded a five-year federal supply contract by the General Services Administration and a Distribution and Pricing Agreement with the Department of Defense. These agreements advance our potential orders with respect to the Government market, as this now provides most Government agencies with a streamlined vehicle to purchase our products and solutions. An example of that was our recent launch of a pilot program with the United States Department of Veterans Affairs. The initial program will provide our medical waste and unused medication disposal solutions to our American veterans in a four-state region bounded by Maryland, portions of Virginia, West Virginia, and Pennsylvania as well as the District of Columbia. We are increasingly confident that the success of our first Government contract and our streamlined product procurement process will lead to additional opportunities and recurring revenue in the Government market.

We discussed in our last quarter's conference call the significant piece of legislation that was passed in California. The legislation requires pharmaceutical manufacturers who sell or distribute medications in California that are routinely injected at home to submit plans to the California Integrated Waste Management Board on or before July 1, 2010, describing how they support and provide safe syringe and needle collection and disposal programs for their patients. We believe our proven Patient Support program is ideally positioned to comply with the new requirements of California, and we are actively marketing it to pharmaceutical manufacturers.

We've been very pleased with the response by the pharmaceutical manufacturers regarding the new legislation in our recent discussions. Although legislation is important, we believe the manufacturers are interested in our Patient Support programs in order to protect the patient and the environment while gathering very important patient data that, to date has been very difficult to compile. David will provide you with details regarding our pipeline and revenue potential.

Most of you know that there are seven states that currently ban improper disposal of used sharps and five states that have introduced legislation. We believe they are observing how California is taking the ban a step further to require action on the part of the pharmaceutical manufacturers.

As to the tightening of the federal and state budgets, we don't see that impacting the programs we are involved in. In fact, from the healthcare perspective and those efforts to reduce costs, we see the opportunity for the home infusion business to grow measurably and that is one of our core markets.

Finally, I want to announce that we've recently begun offering our latest disposal solution, the RxTakeAway Recovery and Reporting System. The system is designed to collect, transport, and destroy large quantities of expired, unused medications, including the H1N1 vaccine. We are finding significant opportunities in this arena, as state and federal agencies are looking for a single provider of disposal solutions. Our capabilities and infrastructure are an excellent fit to provide the solutions. Additionally, our success with our Government programs and credibility through the GSA schedule bode well for us as we present our offerings to state and federal agencies.

With that overview, I'd like to turn the call over to David for a review of our financial performance and some more detail on our marketing and sales efforts.

David Tusa: Thank you, Burt, and good morning, everyone. Thank you for participating in our second quarter earnings call. As you see from the release, revenue for the second quarter of fiscal year 2010 of $16 million was $12.6 million, or 374%, higher than revenue for the second quarter of the prior fiscal year. The revenue growth was generated primarily by two items, the first being $11.5 million in billings associated with our U.S. Government contract for our Medical

Waste Management System, and the second driver being the strength in the flu shot business on the retail market. That increase was $965,000 or a 212% increase, year-over-year in the retail market billings. Those increases were partially offset by the $116,000 reduction in pharmaceutical manufacturing, billings, and about a $100,000 reduction in home healthcare billings. The reduction in Pharma was a result of the variability in the timing of orders of our Patient Support programs and the Home Healthcare market was a bit lower from the impact of additional distributor incentives that we've put in place to drive future growth.

For the six months ended December 31, 2009, revenue was $31.4 million, which was $23.7 or 311% higher than revenue for the corresponding six months of the prior fiscal year. The revenue growth was driven by the $22.5 million in billings associated with the Government contract and a $1.7 million increase in retail market billings resulting from the strong flu shot season. Partially offseting this growth was a $709 thousand reduction in Pharma Manufacturing billings and a $351 thousand reduction in Home Healthcare market billings. Both markets were down in the six-month period due to the same reasons as in the second quarter.

Gross margins for the second quarter were very strong at 67%. This is compared with 38% for the prior fiscal year. Similar comparisons can be seen in the year-to-date period with regard to the gross margins. The increase in gross margins was a result of the substantial operating leverage inherent in the business as the fixed portion of the cost of sales, which is our operations and treatment facility, are increasing at a much lower rate than the rate of increase in revenue and also product mix, meaning the incremental revenue that we're generating is a higher-margin business, which is in Sharps Disposal by Mail System® business and in Medical Waste Management System™ solutions.

The gross margin for the second quarter of 67% was about 400 basis points lower than the trailing first quarter of fiscal year 2010 which ended September 30, 2009. There are a few reasons why it was down a few points. One, we had about $500,000 of subcontracted pass-through costs related to the U.S. Government contract that were recorded in December, which was a relatively low margin. We've also added additional operations personnel as we grow to make sure that we're able to facilitate the operations side as well as the treatment side of the house as we manage the growth of the business. Also, we incurred significant additional costs related to labor, supplies, and utilities to process the flu shot mailbacks that came in during the December quarter that were sold in the September quarter.

Just to reiterate our thoughts on gross margin going forward, we believe a 50% gross margin is sustainable as long as our quarterly revenue is at least in the $7 to $8 million range and higher, as revenue exceeds that level.

SG&A for the second quarter was $2.1 million, which was $667,000 higher than the prior year's level. For the six months ended December 31, 2009, SG&A was $3.9 million compared with $2.6 million for the corresponding period of the prior year, an increase of $1.3 million. The increase in SG&A for both periods was a result of a number of items. Payroll-related expense increased as our headcount went up by eight. The good news is that six of the eight were focused on sales and marketing. Also, there was a significant increase in the 123R stock-based compensation expense that was up about $200,000 for the quarter, about $350,000 on a year-to-date basis. Also, we have had additional sales and marketing related expenses as we continue to get the word out on our solutions and offerings. From a going-forward standpoint, we expect the SG&A for fiscal year 2010 to be about $8 to $8.2 million. It could be higher as we continue to target more sales and marketing activities.

The operating income for the second quarter of fiscal 2010 was $8.4 million, or 53% of revenue, compared with the prior year operating loss of $233,000. The operating income was $17.4 million for the six-month period, or 56% of revenue, a significant improvement over the prior year's operating income of $377,000, or 5% of revenue. The significant increase in operating income is the result of the inherent leverage in the business, as our infrastructure costs, SG&A and otherwise is increasing at a much lower level than the rate of increase in revenue.

Net income for the second quarter was $5.6 million, or $0.38 per diluted share, compared with net income of $1.6 million, or $0.11 per diluted share for the prior year period. The improvement in earnings was actually greater because the prior year's second quarter included a special tax credit of $1.8 million, or $0.13 per diluted share. For the six months ended December 31, 2009, the Company generated net income of $11.4 million, or $0.78 per share, compared with net income of $2.2 million, or $0.16 per share, for the prior year period.

Our tax rate for the second quarter and the year-to-date period was 34%. That's about 150 basis points lower than an expected statutory rate, and we were able to take advantage of a tax incentive from manufacturers. To be technical, it's the Section 199 tax deduction, but we expect about 34% tax rate for the full fiscal year 2010.

The Company's balance sheet at December 31, 2009, was very strong, reflecting cash of about $21.5 million and working capital of about $24 million. This was a significant increase in cash over the September 30, 2009, balance of $8.4 million and the June 30, 2009, balance of $4.8 million. The increase is consistent with the collection of the strong revenue sales during the December quarter related to our Government contract and the retail business, along with proceeds from the Company's recent stock offering and proceeds from stock option exercises.

The income tax receivable of $1.6 million represents tax payments made by the Company in December of 2009 that will be applied to the second half of fiscal year 2010. Our inventory levels reduced to about $1.6 million at December 31, 2009, consistent with the completion of the product build-out phase of the Government contract.

We believe the strength of the Company's balance sheet, including the significant cash balance, is going to prove to be a critical element to our success as we prove out our market opportunity. Let me just give you an example. We have potential sales opportunities that would require additional warehouse space, racking, molds, equipment, leasehold build-out, and working capital needs which is ideal for us because we're not scrambling to raise cash or expand our debt facilities. We have cash in place, and we can focus on taking advantage of the opportunity. As we continue to grow, and we look at treatment facility expansion or multiple treatment facility locations, we have the financial flexibility to implement our growth plans.

Looking forward, we are very much aware of the challenging year-over-year and sequential quarterly revenue and earnings comparatives. When we report our fiscal year 2010 third and fourth quarters, our revenue comps will be at $6 to $7 million, and our sequential quarterly revenue comps will be $15 to $16 million, as we just reported. While we're aware of this, our focus is on the long term, in proving out what we believe to be a multi-billion dollar market opportunity for our Sharps Disposal by Mail System®, Medical Waste Management System™, and RxTakeAway solutions.

How are we going to do this? Well, we plan on closing large dollar opportunities in the Government and pharmaceutical manufacturing sectors. We're also focused on growing our recurring revenue base of business by further expanding our professional market sales through expansion of our inside sales efforts and building our recurring revenue base of Government market sales through our recent DAPA and GSA contracts. While timing is always difficult to predict, we're confident that we have no shortage of opportunities to generate the type of revenue levels we have achieved and higher.

Let's talk more about the Government sector. Our current contract with a Government agency is the first of its kind in any Government agency, local, state or federal. We believe the success of our first program is a key to landing more emergency preparedness business as well as expansion of the existing program. Although timing is difficult to predict, we have a number of sales prospects in progress and are confident in these opportunities.

Outside of emergency preparedness, it's important to note that our VA pilot program is the first of its kind, as the Government recognizes that the millions of patients under their care are not being provided a method to properly dispose of dispensed drugs and unused syringes outside the hospital setting. Over the past few weeks, we shipped our solutions to VA healthcare centers in Washington, D.C., West Virginia, and Maryland. Along with it is a survey so the VA Center administrators can gauge the patient's perception of the program and its ease of use. If rolled out over the entire VA, the program has the potential to address as many as 5.5 million veterans a year, and this would represent a multi-million dollar revenue opportunity for the Company and, of even equal or greater importance, it would be recurring revenue.

The GSA and DAPA are important because they are streamlined approaches for Government agencies to purchase our solution. It also shortens the sales cycle. An agency that is interested in our solution can purchase it on the GSA schedule. This avoids the long duration contracting process as we are already an approved vendor by the GSA and the terms and conditions are already agreed to. The DAPA provides for the efficient procurement of medical products for the Department of Defense. A number have been interested but until now have been unable to purchase because the DAPA (Distribution and Pricing Agreement) was not in place.

Regarding the state program, the Iowa Pharmacy Association program has started out very well. We've shipped about 1,000 of our RxTakeAway™ 20-gallon solutions to about 330 pharmacies across the State of Iowa. About 300 of these 1,000 units represent reorders in the RxTakeAway™ system. On average, each system collects about 700 to 800 prescriptions, over-the-counter medications, and medications that would otherwise end up in the water system or the medicine cabinets within reach of children and teenagers. This is a new solution offering for the state as well as the country as we address proper disposal of unused medications outside of the hospital setting. We're in discussions with a number of other states regarding the program and how we may effectively implement a similar program for them.

Now, let's address the Pharmaceutical market. As Burt mentioned, the Company's in a unique position to facilitate the pharmaceutical manufacturers' compliance with the provisions of California Senate Bill 486. We have six programs in place and, we believe, significant experience with customized Patient Support programs. We have the infrastructure in place, and we can quickly launch programs for prospective customers. Our current sales pipeline of pharmaceutical manufacturing opportunities encompasses over 15 pharmaceutical manufacturers representing an estimated revenue potential in excess of $25 million per year in Patient Support programs. We're in active discussions with at least eight of these organizations and believe we're well-positioned to close a number of these deals in the second half of fiscal year 2010.

Burt mentioned earlier that in the professional market we're very pleased to see the continued growth in this market's billings. As many of you are aware, we've launched an outbound sales program whereby we're reaching out to physicians, dentists and vet offices marketing our Sharps Disposal by Mail Systems® as an alternative to the traditional pickup service. In most cases, the office staff is not aware of alternatives to the traditional pickup service. It's a new offering for them and one that can save 50% and sometimes more on their medical waste disposal costs.

In the last few months, we've been refining our sales approach, and we're already generating close to $10,000 a month in new sales. As a result of that success, we've added additional staff to our outbound calling program and introduced the Sharps Advantage program. This provides three levels of service in varying discounts and additional services based on volume and commitments.

Our internal goals set for our sales reps would be that over an 18 to 24-month period we'd like to see them at a run rate of $400,000 to $500,000 in annual sales. In order to break-even, the sales reps will need to be able to generate about $80,000 per year in sales. So, as you can see, we think that's not only going to be a significant growth opportunity, it would be quite profitable as well. As of today, we have five sales reps on the calls. We expect to hire a few more over the next month or so addressing the hundreds of thousands of professional offices in the country. We believe the introduction of the mailback solution is a new offering to this market and one that will continue to gain traction and bode well for our long-term sales.

As I close, I ask everyone to keep in mind that we believe we're about 1% penetrated in a $2 billion market opportunity. Until we build critical mass and a stronger basis for recurring business, the revenue growth will be lumpy along the way. Yes, we may have a quarter or two where the year-over-year comps are negative, but that's not a bad thing. It's just part of what a growth company experiences, proving out a significant new market opportunity. We encourage all of our shareholders and investors to focus, as we do, on the long-term opportunity versus the short-term outlook.

With that, I'd like to turn it over to the operator to begin the question and answer session.

Operator: Our first question is from the line of Ryan Daniel with William Blair.

Ryan Daniel: Good morning. David, you talked a little bit about the Sharps Advantage program. That's something that's a little new to me. Can you just talk a little bit more about what those different levels consist of, the silver, gold, and platinum? What would a platinum customer get versus a silver customer and, if you want to disclose this, what would the revenue potential of each of those might be? I'm trying to get a feel for the different pricings.

David Tusa: Ryan, Sharps Advantage consists of three different levels, gold silver and platinum. In exchange for a commitment of one or two-years, you may get a 10% pricing break at the platinum level. At the platinum level, we'll provide also alternate returning, packaging, and training level as well. It's a full-service offering in exchange for a commitment, and the commitment level but will provide discounts as well.

It has been seen as pretty positive. I'm looking at a schedule of what our folks have done over the last month and, on average, it looks like for every new customer that they're signing up, it looks like initially maybe 20% of them are taking advantage of the gold program or the platinum program.

Dr. Burton Kunik: They also come with auto ship with that. So, one comes back in, they automatically ship another one to them. It's a very good program for them as well as for us.

Ryan Daniel: I know you disclosed it's starting February 1, 2010. For the following 12 months, it will be about $1.6 million, and then you estimate that the following years will be about $3 million annually. What's the difference between the first year of maintenance being lower and then the other years being a bit higher? Is that just the way the contract is structured, or will there be different services actually delivered in the out years?

David Tusa: That's a good question. The $1.6 million is just the maintenance of the program, warehousing and maintaining the program itself. It ramps up to $3 million in each of the following contract years because there are additional services that are being performed. For instance, the inventory rotation. Over that three-year period, we're paid to rotate the customer's stock with our stock. That's one of the reasons why the program works so well for us. For instance, if in that third year that we want to rotate out a third of the stock, we take a third of their stock and we rotate it with ours, maybe during the flu shot business or during a heavy season, we can replace it with new stock. We have to replace all of the product portion one time over the five-year period.

Ryan Daniel: That makes a lot of sense. And then, you mentioned the Pharma pipeline. It sounds like that's pretty impressive, probably bigger than you've talked about in the past at any point. I'm curious what portion of that, if you look at the 15 leads, and eight that seem to be even more active, how much of that is related specifically to California and helping out there, and how much of that is just broader patient compliance, irrespective of the California legislation?

Dr. Burton Kunik: I think that what we're seeing is that most of the manufacturers, even though California legislation is steering it, it probably won't be just a California supply product. In other words, while they're going to start providing disposal for their patients, they won't just limit it to California. I think that it will carry throughout the United States on most of the programs. There might be a few that will stick to California, but most of them, I think, will provide national programs. David, do you want to add to that?

David Tusa: You know, what's interesting to note about that as well, Ryan, is that the number of drugs that are included in the program involve everything from Multiple Sclerosis to growth hormones, diabetes, rheumatoid arthritis, and Hep C. So, it's many, many different injectable-type drugs with a number of names, the top 10 or 20 pharmaceutical manufacturers. We've been very encouraged and focused on landing more of these Patient Support programs over the next couple of quarters.

Ryan Daniel: I'm a little more curious on the VA relationship. Is there an ability to provide detail? I think you talked about this in the initial press release, but do you know what the timing is, how long they're likely to look at this pilot before they determine if they want to expand it? I assume it's partially dependent, and how well it goes, and what the surveys come back with and can help people view this, but curious, one, if it's a defined time frame or if it's just going to be based on the number of products shipped and surveys returned? Then, the follow-up to that would be, do you think the rest of the VA system will wait to see how that goes, or are you still pursuing other opportunities outside of that distinct market with the VA? Thanks.

David Tusa: Well, Ryan, what we believe, or what we understand, is that the VA will probably take three to six months to evaluate the program, and it'll be everything from not only the response to the surveys, but also the data we'll provide on what's coming back. For instance, on the RxTakeAway™, what's the estimated number of prescriptions that are being disposed of? We will be providing a lot of data with regard to the program because the idea is to take the syringes and the unused medications out of the waste stream. So, we predict three to six months.

The VA is one program that we're looking at. We're talking with a number of other Government agencies about everything from the normal, recurring day-to-day Sharps Disposal by Mail® and RxTakeAway™. We're talking about emergency preparedness opportunities and some other opportunities as well, as Burt mentioned, the recovery program that we've recently launched. We're starting to respond to some requests for disposal of vaccines with state and federal agencies. There's much more going on than just the VA. I use that as an example because what I tried to point out is, this is all new. This has never been done before in the Government sector, it's just now started to take hold in the commercial sector.

Operator: Thank you. Our next question comes from the line of Kevin Steinke of Barrington Research Associates.

Kevin Steinke: Good morning. I noticed in your press release, you talked about support for the city of Chicago immunization program and some billings related to that. I was wondering if you could provide a little more color on what that was and if there's additional opportunity with the city or for other municipalities?

David Tusa: The city of Chicago really took the lead, we believe, in launching an immunization program with respect to flu shot and H1N1 for its city, and we are working with a company that's actually administering and managing the flu vaccine. We were brought in as a provider of the disposal of the syringes used to administer the vaccine. The vaccines are administered in multiple locations in Chicago. Our product was the perfect solution for the program. The pickup service didn't work, and they wanted better control of the medical waste and disposal of it at the individual facility.

Yes, we believe there are some additional opportunities with the city of Chicago, and yes, we do believe that there are similar opportunities with other cities and states as well. But it was a real model for how we could work with the state and their immunization programs and provide proper disposal and cost-effective disposal of the syringes as well.

Kevin Steinke: You talked a little bit about the Iowa Pharmacy Association and the shipments there, are they actively marketing that to other states yet, or are they still working on that?

Dr. Burton Kunik: As far as the Iowa program itself goes, it's been very successful by the Iowa Pharmacy Association to this point, and they definitely are marketing to other states. They think they have a real good program with us, and they're marketing to the other states, and we need to incentivize them to do well with it. So, we're very encouraged by what's taking place there.

Kevin Steinke: You talked about potentially expanding the contract with the federal Government agency, and I'm just wondering what would prompt them to do that?

David Tusa: The Medical Waste Management System™ program that we have in place for our Government agency at this point does not address unused medications. In the event of an emergency, there are unused medication issues that would have to be addressed as well. We would propose to add our RxTakeAway™ solutions to the existing Medical Waste Management

System™ program so the unused medications as well as syringes could be addressed in the event of an emergency.

Kevin, this is a relatively small program. We're very excited about the success of the program and work very well with our customer. We think that this potentially could be the beginning of a larger program.

David Tusa: We've got a question that came in via the Internet. If we're not as fortunate to win another large Government or similar contract, what will be the margin expectations and the expectations regarding SG&A?

As I mentioned earlier, as long as we're generating $7 to $8 million plus in revenue, we believe the gross margin is sustainable at 50 plus percent. If it does drop below that, to the $4 to $5 million a quarter in revenue, you're looking at the low 40% gross margin level. Of course, when it goes past the $7 or $8 million to $10 to $15 million, then it's above the 50% gross margin level, which we're seeing in the current quarter.

Even as this initial Government contract, the product portion, is completed in December the SG&A is going to continue to grow because the SG&A is focused primarily on sales and marketing to generate more large opportunities. So, we're going to continue to invest dollars in sales and marketing to generate more opportunities.

Just to give you an idea at June 30, 2009, we had zero inside sales, about six outside sales folks, and one Government salesperson. As of today, we're up to five inside sales persons, eight outside sales professionals, two Government sales personnel, and two consultants we're working with as well on the Government sales side. So, we've grown, and invested the incremental SG&A dollars in sales and marketing. So, we're going to be smart and spend the money smart because we think it's important to be able to continue to generate the kind of revenue opportunities we've seen in the past.

Operator: Our next question comes from the line of George Walsh of Gilford Securities.

George Walsh: David, could I ask another question relative to the market penetration, just in terms of the Medical Waste Management System™ contract with the Government, can you describe the population coverage the current contract is supposed to deal with, and what it might be designed to cover in the future if it really needs to be rolled out in a more meaningful way?

David Tusa: George, we're under a confidentiality agreement. We can't even name the agency that we're working with. To get into details like that is something they don't want us to do. It's a sensitive project. But I will just say that we think that there are opportunities to grow the program and, hopefully, this is just the initial program of something which could be larger.

George Walsh: With all the sales centers you have, do your salespeople also act as the follow-up, or is there a different maintenance group that is following up with existing clients?

Dr. Burton Kunik: Our sales group also does follow up with our existing clients. They take responsibility of continuing the sales process as the years go by.

Deborah Pawlowski: David, talk about the incentive program, how they have to build on the prior year's sales.

David Tusa: We have two different types of incentive programs. One, for our core business, our salespeople are paid a commission based upon the growth in their book of business. If their book of business doesn't grow, they don't get any commission. If their book of business grows, they get a portion of that as their commission. So, for instance, on the retail side, we've seen significant growth and significant additional penetration in that retail market, the salesperson in that area did quite well, and we're very happy to pay her that commission.

Now, on the larger Government opportunities where we're starting to build a base of revenue, the commission is based upon a percentage of revenue. On our inside sales, since we're launching this and it is new and they're building their book of business at least for the initial year, we pay a percentage of the sale, to the commission to the individual and to that salesperson.

George Walsh: With your line of credit with JPMorgan, as you beef up the balance sheet, will you increase the line that's available to you?

David Tusa: We have looked at that, and it's driven a lot by our working capital, our receivables and inventory levels. Right now, the $2.5 million is consistent with the inventory and receivables that we have post the build-out of the Government contract. But as we grow, yes, and as those numbers increase, we'll look at expanding the line as well.

Operator: The last question comes from the line of Walter Young of Thompson, Davis.

Walter Young: My question is, if you could expand on the future need to expand your capacity what percent of your capacity you're using now would that include? I think you've mentioned before that this might be expansions on either coast, and I wondered if that's a geography issue or because you would run out of capability?

David Tusa: Walter, good question. Yes, roughly, 10% of the capacity between the autoclave and the incineration. If we expand, it'll be more than just increasing the capacity. There would be multiple locations in an effort to reduce our return transportation costs. For instance, if we had an autoclave facility on the West Coast and the mailbacks were returned from the patients who lived in Seattle to our West Coast facility, then the costs associated with that would, obviously, be lower. At the same time, we would generate additional capacity. So, really, it is two things, capacity as well as the potential then to improve our infrastructure and reduce costs.

But one of the things we've done, and I think we've really done right, is we're always focused on additional capacity or having significant excess capacity because when you're looking at the type of opportunities we're looking at, one of the first questions is, "Well, can you handle it? Can you handle the treatment side?" And the answer is always, "Yes, we have significant excess capacity." So, we think an investment in that makes a lot of sense.

Walter Young: Any comment about what that could cost?

David Tusa: Well, Walter, you're probably looking at $2 to $3 million if we expand the facilities in the West Coast or maybe invested in another place, somewhere in that neighborhood. It's not $20 million, but it's not $1, probably $2 or $3 million.

David Tusa: Burt, maybe you can take this question that came in through the Internet. It's asking to comment on the departure of our VP of Operations. Will that impact our business, and how is the search going?

Dr. Burton Kunik: Our VP of Operations, we didn't expect him to leave, but his wife just landed a contract in their hometown area there, and they changed their mind. They were looking for homes here, and so it's just one of those family things that happen.

But we are really well-positioned here. We have excellent staff in place. We moved our VP of Operations over into VP of Quality Control not too long ago, and we won't miss a beat over here. Our search is well on its way. There are lots of good candidates out there in today's market, and we're actively interviewing candidates. I'm pretty confident we're going to find somebody very good to come in here to be the Senior VP of Operations.

David Tusa: Scott's a great guy. We really enjoyed working with Scott and his family came first, which is very important. What we really learned is that one thing that attracted us to him was his significant entrepreneurial experience in addition to experience working with large companies, and we've really framed the search around that type of experience, entrepreneurial as well as large company, and we're meeting with candidates as we speak.

Operator: We have a follow-up question from George Walsh of Gilford Securities.

George Walsh: I just had a quick question on the Senate Bill 486 in California. That is on medications that are injected, so that is what you'd be dealing with now, with the syringes. I think previous conversations were also a bit on just unused medications pills, etc. in terms of disposal of those. Is that something that is not included in this legislation or something you expect to be doing anyway relative to the movement with this type of legislation?

Dr. Burton Kunik: The Senate Bill 486 is strictly dealing with the disposal of used syringes. The other unused medications, in pill form, that's not included here at all. But, you know, this is a big movement. It's the first time the pharmaceutical manufacturers have ever felt a need legislatively to address the disposal of the used syringes they provide to patients. So, it is just for that and not for the pills, that's a separate item and not in legislation right now in California.

George Walsh: But is that something that's part of the service you'll be providing, or are the pharmaceutical companies taking an initiative on that?

Dr. Burton Kunik: On the unused medication, the pills and all that?

George Walsh: Right.

Dr. Burton Kunik: The pharmaceutical manufacturers are not playing a role in it just yet. But when you look at what product stewardship's all about, I think they're realizing that they do probably have a role in managing the unused medication because the end-of-life of products that need attention is being very definitely addressed today in many, many products. I think you're probably going to see their activity evident in the future.

Operator: There are no further questions in the queue at this time. I would now like to turn the floor back over to Dr. Kunik for closing comments.

Dr. Burton Kunik: We continue to develop our market and prospects, and believe there's a huge growth potential on what we estimate is a $2 billion market opportunity. As David described, we have significant prospects in our pipeline, and it's our expectation that some of those will close in the second half of fiscal 2010. We also believe that our upcoming third quarter will benefit from some residual flu shot business.

In addition to targeting large Government contracts and pharmaceutical business, it is our plan to continue to grow our core markets as well as recurring Government business. We will invest in sales and marketing when strategically appropriate. However, we are confident that the organization is well positioned for the long term, and are excited about our prospects. Thank you for your time and interest in Sharps.