Operator: Greetings, and welcome to the Sharps Compliance Corporation Second Quarter 2011 Quarterly Results Conference Call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mrs. Deborah Pawlowski, Investor Relations for Sharps Compliance Corporation. Thank you, Mrs. Pawlowski, you may begin.

Deborah Pawlowski: Thank you, Jackie, and good morning, everyone. We appreciate your participation in Sharps' second quarter fiscal year 2011 earnings conference call. You should have a copy of the news release that detailed our financial results that was put out earlier this morning, but if not, you can obtain a copy from the Company's website at www.sharpsinc.com.

On the call with me today are the Company's CEO and President, David Tusa, and Vice President and Chief Financial Officer, Diana Diaz. David and Diana will provide formal remarks, after which we will open it up for questions. If you are listening via the webcast you have the ability to submit questions via the Internet as well.

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 today. 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. Those filings can be found also on our website as well as the SEC's website, sec.gov.

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

David Tusa: Thank you, Debbie, and welcome everyone to our second quarter fiscal year 2011 earnings conference call. We continued to make progress during the quarter in the development and penetration of what we believe to be a $2 billion market for the proper management of medical waste and unused medications generated outside of the hospital and large health care setting. Our proven line of solutions are seen as value added offerings by our customers, which include government agencies, major retail pharmacy chains, professional offices, clinics, home health care companies and other smaller quantity generators of medical waste.

Revenue in our fiscal year 2011 second quarter was $4.6 million, which was $11.4 million lower than the prior year. Now, if you exclude from both periods, the revenue associated with our large U.S. government contract, which was about $400,000 in the current quarter and $11.5 million in the prior year quarter, revenue decreased at a rate of 7%. Fiscal year-to-date revenue in fiscal year 2011 of $9.8 million was $21.5 million lower than last year, and again, excluding the U.S. government contract revenue of about 800,000 on the current year-to-date basis, versus $22.4 million for the prior year, revenue increased at a rate of about 2%.

Our professional market billings grew at a rate of 38% in the second quarter of fiscal year 2011 and we expect this growth rate to continue to accelerate from here. The increase was a direct result of our targeted telemarketing activities, as well as higher sales through our distributor network. We believe we have made measurable headway with our inside sales efforts to educate the estimated 800,000 professional offices and similar facilities across the country, which generate smaller quantities of medical waste in a regulated environment, about our cost-effective and convenient alternative to the traditional medical waste pick up service. It's important to note that this professional market is required by law to properly dispose of the medical waste that is being generated. Our solutions are designed to facilitate compliance with the regulations for all medical waste generated in these settings at a cost on average which is 50% less than the traditional pick-up service.

During the second quarter of fiscal year 2011, our inside sales team contributed $148,000 of the $519,000 in professional market billings. The second quarter inside sales performance matched our internal targets, while the January 2011 performance is actually exceeding our internal expectations. And we believe that in our March 2011 quarter, that billings attributable to the telemarketing initiative could be as high as $300,000, which is doubling the revenue on a sequential quarterly basis for this initiative. To put this professional market opportunity in perspective, if we penetrated, say 7% of this market, the 800,000 professional offices and similarly regulated facilities in the country, we would generate over $40 million in annual revenue from this opportunity alone, which is equal to the revenue generated by the entire Company for the fiscal year ended June 30, 2010. So, obviously, we continue to be very excited about the opportunity of the professional market.

Our retail billings for the second quarter of fiscal year 2011 were adversely affected by the deferral of about $800,000 in orders to the March 2011 quarter, as a result of the temporary suspension of the TakeAway System™ envelope solution, which occurred in early November 2010. Also in the retail market, the flu shot business, and for the December quarter, it was lower than the prior year and this was really attributable to the fact that the prior year December quarter included H1N1-related flu shot activity. Also, we did not experience as much media coverage of the dangers of the flu in this year's December quarter. So overall, the retail market billings were down $649,000, or 46%, to $771,000 in the December quarter.

Although the TakeAway System™ envelope solution re-launch took a bit longer than we had originally anticipated, its important to note that we are the only company in the U.S. permitted to provide this comprehensive, managed solution for the proper disposal of unused dispensed medications, other than controlled substances, through the mail. And, importantly, our product line will now include permanent shelf presence in some of the nation's largest drug chains. Given the approximately 50,000 retail pharmacies in the U.S., we estimate the total annual market for this offering in this market alone to be in excess of $40 million.

We believe the re-launch of our one-of-a-kind TakeAway System™ envelope solution establishes Sharps as a provider of choice, with a key differentiator and a competitive advantage in the marketplace. And we've also recently launched a new and larger sized TakeAway envelope with an alternative logistics provider. The larger size provides for a cost effective and convenient method of disposing of larger quantities of unused medication; say for a family instead of just an individual. Looking forward, we believe the TakeAway System™ envelope solution will positively impact customer billings, not only in the retail market, but in the government market as well. And as I've said on previous occasions, I believe that the calendar year 2011 will be the year where the unused medication solution will make an impact on our consolidated revenue.

Outside of our large U.S. Government agency contract, our government market billings for the second quarter 2011 were down $178,000, also as a result of the temporary suspension of the TakeAway System™ envelope solution. The envelope solution was a key part of our VA pilot that has been contributing revenue in the government sector. The VA pilot continues to progress and is currently operating in 22 states, plus the District of Columbia. For the six months of the fiscal year 2011, core government billings of $291,000 were consistent with the prior year period.

We continue to make progress in the rollout of the VA pilot, to the VA Pharmacy Services Division, which serves five and a half million patients. The project now has dedicated personnel studying the potential rollout and the positive impact the program would have on the VA, their families, the communities, as well as the environment. So simply said, we've moved from them liking the program, which they do, to studying the program and looking at it for the potential rollout.

Sales to the pharmaceutical manufacturing industry continue to fluctuate due to the variability in timing associated with the Patient Support Programs that we provide to drug manufacturers. We're looking at a number of alternative sales approaches to the pharmaceutical manufacturer market that seem to be gaining traction and could possibly impact our calendar year 2011 billings. We should have a further update on this market opportunity as part of our March 2011 quarterly call.

As you saw in the earnings release, we implemented a program late in December of 2010, whereby we've reallocated resources throughout the Company to be better aligned with the implementation of a more targeted and aggressive sales, marketing and market awareness building strategies.

We decided to change the way that we're investing some of our resources in order to create a greater impact on the professional market, pharmaceutical manufacturer, retail, and assisted living markets. We're now taking a more deliberate, research-based, targeted and multi-layered approach to our sales and marketing activities that we expect will accelerate our rate of growth. The program included headcount reductions, while at the same time upgrading talent; budget cuts in certain areas to accommodate new promotional and sales programs, while adding broader market access through the internet, other electronic media, as well as our very strong distributor network. And we expect our multi-pronged approach to create demand, increase awareness of our Company and our solutions, and will allow us to further penetrate our targeted audiences more rapidly, resulting in an increased rate of growth.

And with that, I'm going to turn it over to Diana, who will talk a bit more about the financials.

Diana Diaz: Good morning. Gross margin for the second quarter of fiscal year 2011 of 27% was adversely impacted relative to the prior year period due to lower volume and a higher cost structure from investments made to expand and upgrade the Company's infrastructure. Compared with the trailing quarter ended September 30, 2010, gross margin declined 800 basis points on lower volume. We believe the infrastructure expenditures made over the past year were critical for positioning us for future growth, and we continue to believe that we have the infrastructure in place to facilitate another large U.S. government program, as well as two to three times our current core business.

The GAAP adjustment, which is the difference between customer billings and revenue recognized, was a positive $559,000 for the second quarter of fiscal year 2011, consistent with the return of units sold during the June and September 2010 quarters to the flu shot market customers.

Our sales, general and administrative expenses, or SG&A, for the quarter of $2.3 million was about 11% higher than the prior year amount, but about 4% lower than the trailing sequential quarter. For the six months ended December 31, 2010, SG&A expense was $4.7 million compared with $3.9 million for the corresponding period of the prior year, an increase of about $800,000 or 20%. Also included in the first quarter was a special charge of $570,000 related to the planned retirement of the Company's former CEO. The special charge included a non-cash portion of $73,000 related to the acceleration of unvested stock options.

As David noted, we've reallocated resources to address our more targeted, multi-layered sales efforts. So, although our spending is relatively flat with last year, the reallocation discussed earlier allows more spending on targeted sales and marketing initiatives. Unless we see a need to flex higher for additional sales and marketing programs, SG&A expense for fiscal year 2011 should hold at about $9.5 million or about $2.4 million per quarter.

As of today, our total headcount is 62, which compares with 55 a year ago. The current headcount includes sales and marketing personnel of 29, of which 12 are inside sales, 7 are field sales, 6 are customer services, and 4 are sales support. We believe the continued investment in sales and marketing-related personnel and related expenditures to be a critical element of our success in landing more opportunities in our key markets.

Operating loss for the second quarter of fiscal 2011 was $1.2 million compared with operating income of $8.4 million for the prior year's second quarter, and an operating loss of $1.2 million for the trailing quarter of September 30, 2010. For the fiscal year 2011 second quarter, the Company generated a net loss per diluted share of $0.05 versus net income of $0.38 per diluted share for the corresponding period of the prior year. For the six months ended December 31, 2010, the Company generated net loss per diluted share of $0.11 versus net income of $0.78 per diluted share for the corresponding period of the prior year. The $0.11 loss per diluted share for the first six months of this fiscal year included the special charge of $0.02 per diluted share related to the retirement of our former CEO.

Our balance sheet remains very strong with about $18 million in cash and $22 million in working capital at December 31, 2010. In addition to our cash balances, we expect a federal income tax refund of $2.6 million by the end of calendar year 2011. We have no debt and a $5 million bank line of credit. Based on the current level of infrastructure, including the SG&A expense, we expect breakeven results consistent with quarterly revenue of $6 million to $6.5 million.

David?

David Tusa: Thanks, Diana. Before we open the floor up for questions, I just want to make sure that everyone takes away just a number of, what I believe to be very critical points. First, we're making significant changes in the way we approach our sales, marketing and awareness. We are already seeing the benefits of the changes and are very encouraged with what we are hearing from customers and prospects.

Second, we have a more robust pipeline than we've had in my history with the Company, and these are opportunities that are exciting as our first large government contract that we landed in 2009 and, as another example, creation of the retail clinic business, just to name a few. But over the last several months, there have also been changes in our pipeline, specifically, opportunities are moving to later stages in their sales cycle. We're also seeing opportunities move quicker through the sales cycle in all of our key markets, and we're very busy with customer presentations and submitting proposals with existing and prospective customers on these opportunities.

Third, we see the convergence of the issues regarding the environment, the cost of healthcare, changes in our healthcare delivery system, and cost saving initiatives by our customers to be very apparent. All of these items have a positive impact on our business and our ability to close deals. These factors also influence the decision-making process of our customers, current and prospective.

And the last comment, we have a proven operational infrastructure and team that can handle rapid growth. We're ready for the challenge with the many programs that we're proposing coming to fruition.

So with that, Operator, we can open it up for some questions.

Operator: Thank you. Ladies and gentlemen, we will now be conducting a question and answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment, please, while we poll for questions.

Thank you. Our first question's coming from Ryan Daniels of William Blair.

Andy O'Hara: Yes, this is Andy O'Hara in for Ryan today. A couple of quick questions. First of all, on the TakeAway System, can you guys give a rough breakdown of that between the retail segment, so the Walgreens' contract and the VA pilot that you guys are doing?

David Tusa: Well, right now the majority of the revenue that we're generating on the TakeAway is in the retail section, the retail pharmacy chains. Now the VA pilot, we are generating revenue - a couple of hundred thousand for the year-to-date period under the VA pilot. But what you're going to see, is the majority of the contribution from the retail pharmacy, the major retail pharmacy chains, throughout 2011, at least until any VA pilot rollout begins.

Andy O'Hara: Okay, so related to that, the $800,000 in deferred TakeAway billings, the vast majority of that is from the Walgreens' side.

David Tusa: Well, we don't try to talk about any particular customers. I'll just say that that $800,000 is primarily from the major retail pharmacy chains. The bad news is it adversely impacted the December quarter, but is a great way to start the March quarter.

Andy O'Hara: Right. Okay. And then in terms of the pharmaceutical setting, can you just talk a little bit more in detail about the alternative marketing approach that you're taking with those guys? Just any more color would be helpful there.

David Tusa: That is a good question and I'll tell you, we're right in the middle of it right now, and I'd really like just like to defer that to the March quarter, as we give an opportunity for it to develop.

Andy O'Hara: Okay. And then I guess just one more, very similar to that; in terms of your overall new sales and marketing approach, I mean can you give any more color in terms of where you anticipate the headcount reductions, where you think you'll be adding additional resources? Just any color there, I think would be helpful for us.

David Tusa: Our overall reallocation of resources had an impact of roughly, on an annual basis, of about $800,000. And what we're doing is we're reinvesting that $800,000 into targeted marketing and awareness and sales campaigns, and again, we're starting to see some of the impact of it. And we're launching it as we speak, and over the next 30, 60 days we're launching many, many more initiatives. So, again, I think at the March quarter we'll be in a much better position to be able to describe some of these initiatives and the impact they're having.

Andy O'Hara: All right. Thanks a lot, David.

Operator: Thank you. Our next question's coming from Joe Munda of Sidoti & Company.

Joe Munda: Good morning, guys.

David Tusa: Hey, Joe, how are you?

Joe Munda: Good, how are you? I am not sure if I heard correctly; I think the last point Diana had brought up, you guys were expecting $6 million to $6.5 million for the third quarter, is that correct?

Diana Diaz: No, what I was saying was is that we would achieve breakeven results if our revenues were at the $6 million to $6.5 million level.

Joe Munda: Okay. I'll just make a note of that. David, I was wondering if you can go into a little bit more into the investment of—in infrastructure and the tick down quarter-over-quarter of the gross margin. What led to that? What kind of investments in infrastructure are you guys making?

David Tusa: Well, over the last year, we've made a significant investment into the operational infrastructure; that's everything from warehouse space, to racking, to personnel. It's that fixed level of—it's a fixed level included in the cost of sales, the infrastructure. And, Joe, I've mentioned it before that we find this very important because we think that we need to have the infrastructure in place for a much larger Company. We could facilitate another large government deal and we could probably do 2x on the core business, and we have the infrastructure in place to facilitate that and that's really important when you're in a situation where you're growing and you're growing rapidly.

So, in the September and December quarters, you saw the positive impact of operating leverage, and when the revenues are down in quarters as this, you'll see the negative impact of the operating leverage because that fixed structure is there to facilitate the growth. But as we grow this Company and land some of these larger deals, you'll understand why it was very important to have the infrastructure in place.

Joe Munda: Okay. And I just have one other quick question. You talked about the VA. Now, if the VA was to "rollout" a program, what would be the timetable on that?

David Tusa: That's a good question, Joe. We've been working with the VA for quite a while, since the beginning of 2010. We're very encouraged by the fact that it's moved now to dedicated personnel. But as you know, with any government type of contract or government situation, they're very difficult to predict. But we'll just say that we're very pleased with how it's moving.

Joe Munda: I'm sorry, and David, I just had one more question. Can you talk a little bit more about the current flu shot season? And do you see any other possible vaccinations down the road that could drive that space?

David Tusa: Well sure. I mean, what's happening in that space is health care, especially with respect the administration of flu shots and other shots, continue to be moved outside the traditional setting, into the alternate setting, which is our market. So, I think we'll continue to see this market grow just because there's going to be more and more health care administered in the alternative setting, as well as the opportunity for more flu shots. You know, this was a little bit of a strange flu shot season this year, but overall on a calendar year basis, it was pretty much flat.

We continue to be very encouraged by this market. We're the leader in the retail clinic setting, and we think we're well positioned to take advantage of the growth.

Joe Munda: Okay. Thank you.

Operator: Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, you may press star, one on your telephone keypad at this time. Our next question's coming from George Walsh of Gilford Securities.

George Walsh: Morning, David.

David Tusa: Morning. How're you doing?

George Walsh: Good. Just, the current burn rate you're at with this revenue stream, is that something that we should expect over the next several quarters, or do you expect that to moderate, because there were some of the timing issues and the delay issues you mentioned?

David Tusa: I think it's going to moderate. It was unusual for this quarter. Obviously, when you defer $800,000 in revenue, that is an anomaly that adversely impacts the bottom line. But I think it's going to moderate and our job is to keep that cash on the balance sheet while growing the Company, so I think you'll see it moderate going forward.

George Walsh: Okay. And could you speak a bit to the new hire that you made as the, I believe the office is Chief Operating Officer, and how that affects some of the plans you were mentioning there and maybe some other things?

David Tusa: George, a very good question. You know, when I put this team together, or when I moved into the role that I am now, I wanted to make sure that we have the right people in the right place. And I want to hire people with significant experience in both the large and small company setting and people that can be with us as we grow this Company substantially. So, I wasn't hiring for today; what I was hiring for is the future. And Ramsey Hashem, our COO, brings a tremendous amount of experience and is already starting to make quite an impact. But we want to hire big because it's all about people; at the end of the day, a business is all about people. So getting all the right people in the right spot and hiring big is very important to our ability to successfully implement our business plan.

George Walsh: Okay. Could you just go into a little more detail in terms of describing his duties versus what you were doing, and you know, how are the roles changing within the Company, Dave?

David Tusa: Right now he is working on the operations side of the house, manufacturing and distribution; also our treatment facility, which is out in East Texas, and he's also now responsible for customer service. And that's kind of change for us, but it's one that we think that makes sense. Ramsey is relocated and is planted here in Houston, Texas and these functions are here in Houston, Texas, well other than the treatment facility, which is not too far away. So, we're on the ground, right here, working with these operations, or with these functions to work with them to facilitate the growth of a much larger Company.

George Walsh: Okay. And just in general again, in terms of the pipeline, how much marketing efforts are you dividing between the core businesses you talk about and these larger contract potentials that are there? How is the sales force divided between those prospects given one is a longer timely decision, like the larger ones, like the government contracts, and maybe the professional markets that you're talking about, with perhaps a significantly shorter sales cycle and time decision making?

David Tusa: The large deals that we're talking about, whether it's in the retail side or whether it's the government side, we have dedicated personnel. And on these larger opportunities, our Senior VP of Sales, Claude Dance, takes a very active role in these much larger opportunities. But the marketing efforts, the awareness efforts and the targeted sales activity, or our investment sales, really address more the opportunity outside of the large ones. And whether it's the professional market, whether it's the smaller retail clinics, whether it's assisted living market, we really want to make sure that our solution offerings are much better known.

And, I told you George, we've talked about before, if you take, for example, the professional market which is becoming more aware, but we want to make them much more aware of the fact that there's an alternative to the traditional pick-up service, and that alternative is our mailback, and that the alternative is cheaper. So, we want to do a better job of getting in front of that marketplace in many different ways. Again, I don't want to go into all the details of what we're doing, but I think that we'll see an impact on moving that core business, which is good solid recurring revenue business.

George Walsh: Okay. Are you targeting certain sized practices versus, you know, like various doctors working together? Is it single practitioners, or how are you working that?

David Tusa: Well, first of all, what we're doing is we're working hard to make that sector aware of our solution offerings. And with that, we do have some more direct targeted marketing that's typically something on the lines of maybe two, maybe a three-man shop from a professional office standpoint. But that's the majority of these professional and similar offices, whether it's doctor, dentist, vet, tattoo, allergy clinic; I mean, there are so many of them, and actually, a significant portion of those are candidates for our solution.

George Walsh: Okay. And just one more, David. Could you describe the efforts with the pharmaceutical companies you mentioned there, I guess relative to TakeAway? And are they feeling that, you know, is that a conduit for those services you think, is that developed and, because you're at the retail end but are the—do the pharmaceutical companies want to—you know, how do they feel about doing that kind of initiative?

David Tusa: Well, let me just leave it at this, George. Right now, we're focused on the retail pharmacies. The retail pharmacies are very interested in the offering and we think it's going to be quite a success for the year. With respect to pharmaceutical manufacturers, I'm going to save that for the March call. We've had a couple of initiatives that we have going on and I really don't want to get into that right now. But I'll be giving a much better update on that in the March quarter.

George Walsh: Okay. Thank you, David.

David Tusa: Thanks, George.

Operator: Thank you. Our next question's coming from Michael Smith of IBC.

Michael Smith: Hi, good morning, guys. Couple of questions here; you had mentioned in your prepared remarks that some of the opportunities that you've been working on are moving to the later stages of the sales cycle. Can you elaborate at all on that as far as sizing of these opportunities and maybe how far off they possibly are?

David Tusa: When I spoke to it earlier, I mentioned that some of these opportunities that we're working on are as exciting and as large as our initial government contract and as large as the creation of the flu shot business in the retail clinic. And again, I don't want to get into a lot of specifics, but I will just say that the sales cycle is shortening; the opportunities are in the later stages. And I would say that it includes the government sector and includes the retail pharmacy sector, as well as many opportunities in professional and assisted living so really across all lines. But the important point is, is that they're in the later stage and moving much quicker through the pipeline.

Michael Smith: Yes, that's great to hear. Also, I believe on the last call, you guys had also said that your breakeven point was between \$6 million and \$6.5 million, but I think you had said that you expected to reach that in fiscal '11. Is that still along those same lines?

David Tusa: Well, I think what Diana said is that she was just trying to give you an idea what our breakeven point is, which was the \$6.5 million. But I'll just tell you this; it wouldn't take closing too many opportunities to be able to reach that pretty quickly.

Michael Smith: Okay. Thanks very much, guys.

Deborah Pawlowski: David, we do have one question from the Internet regarding the incinerator, and the question is, do you expect to upgrade or reinvest in your incinerator due to anticipated volume increase?

David Tusa: Right now, we have both incineration and autoclave capabilities and that's something actually that we're looking at. We have plenty of capacity for what we're doing, but we are actually working on potential plans for expansion and—but that's something that's important because, you know, that just doesn't happen overnight. There's usually up to a one-year lead time in a program like that. But, yes, that's something that we're looking at and it's something that will be part of the growth plan. But let me just say this, right now we have plenty of capacity to facilitate the business.

Deborah Pawlowski: Operator, I don't think we have any other questions on the line?

Operator: There are no further questions over the phone so I'd like to hand the floor back over to Mr. Tusa for any closing comments.

David Tusa: Thank you, Jackie. Let me just close by saying we're in a very unique position and a interesting time. We have the convergence of national health issues, environmental awareness, the changing structure of our healthcare delivery, as well as cost saving initiatives, which are very important with our customers and prospective customers. All of these things are driving the needs and demand for our solutions. Again, we provide the cost effective, responsible, environmentally conscious approaches to handling unused medications and medical waste in the non-hospital setting. As we develop and expand our relationships with our customers, we are seeing these factors drive their decision-making process, which supports our belief that we can be the leader in this yet-to-be-tapped $2 billion market opportunity.

I hope you share our excitement in the business and our opportunities for growth. Thank you for your interest in Sharps and we appreciate your support and participation in today's call.

Operator: This concludes today's teleconference. You may disconnect your lines at this time. Thank you all for your participation.