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Transcript of
Sharps Compliance, Inc.
Second Quarter 2015 Earnings Conference Call
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Participants

John Nesbett – Investor Relations, Institutional Marketing Services
David Tusa – Chief Executive Officer and President
Brandon Beaver – Senior Vice President of Sales
Diana Diaz – Vice President and Chief Financial Officer

Analysts

Joe Munda – Sidoti & Company
Kevin Steinke – Barrington Research Associates
Brian Butler – Stifel, Nicolaus & Co.
George Walsh – Gilford Securities

Presentation

Operator
Greetings and welcome to the Sharps Compliance Corp. Second Quarter 2015 Earnings Conference Call. At this time all participants are in a listen-only mode. A question and answer session will follow the formal presentation. (Operator instructions.) As a reminder this conference is being recorded.

I'd now like to turn the conference over to your host, John Nesbett of IMS. Please go ahead.

John Nesbett – Investor Relations, Institutional Marketing Services
Good morning and welcome to our conference call to discuss Sharps Compliance's financial results for the second quarter of fiscal 2015. On the call today, we have David Tusa, Sharps' President and Chief Executive Officer; Diana Diaz, Sharps' Vice President and Chief Financial Officer; and Brandon Beaver, Senior VP of Sales.

David will review the company's business operations and growth strategies and Diana will review the financials. Brandon will discuss the sales organization and related sales initiatives. Immediately following their formal remarks, we will take questions from our call participants.

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

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

David Tusa – Chief Executive Officer and President
Thanks, John, and good morning, everyone, and welcome to our Second Quarter Fiscal Year 2015 Earnings Conference Call. Fiscal year 2015 remained strong with customer billings of $8.7 million for the second quarter,

an increase of 20% over the prior year and a sequential quarterly increase of 16%. The increase in billings for the quarter was driven primarily by growth in the retail market where our mailback solutions facilitate the cost effective disposal of syringes used by retail pharmacies primarily in flu-shot season. We also saw solid gains in the professional market during the quarter, as well as growth in the pharmaceutical manufacturer market for the fiscal year-to-date period. Furthermore, we saw significant operating leverage as our revenues grew much faster than expenses. This resulted in improved gross and operating margins and a significant increase in profitability to net income of $749,000 or $0.05 per share for the quarter.

Let's review a few of our core markets and their performance for the second quarter. Retail market billings grew 67% to $3.1 million in the second quarter, and 37% to $5.1 million for the 6 months ended December 31, 2014. These increases were due primarily to the strength in our flu-shot related business, which benefits from the continued trend of flu-shots and other immunizations being administered in alternate site settings including retail pharmacies.

Professional market billings grew 30% to $1.7 million in the second quarter as we continue to roll out sales initiatives and promotional activities focused on educating doctors, dentists, vets, and other healthcare professionals about our Sharps Recovery System. We believe our mailback systems offer significant cost savings, operational efficiencies and convenience for the small quantity generator sector.

Billings in our pharmaceutical manufacturer market vary from quarter-to-quarter, due to the timing of bulk orders for our vendor-managed inventory programs. In the second quarter, we saw billings in this segment which were lower than the prior year. However, year-to-date, we've seen pharmaceutical manufacturer customer billings grow 31%. During the second quarter we filled a large order for a new inventory build for an existing customer and we launched a new patient support program for a new drug. We expect to launch three additional patient support programs for new drug therapies during calendar year 2015 and the first half of calendar year 2016. We continue to build on our strong relationships in this sector and believe our ability to provide innovative, customized programs for our customers and their patients represents a significant growth opportunity.

As a company our success lies not only in our ability to generate significant organic revenue growth but also our ability to anticipate and respond to changes in the markets we serve, with the introduction of new products and services. In October 2014, we launched MedSafe, our new solution geared to the convenient and cost-effective disposal of unused medications including controlled substances. We developed MedSafe to help our customers solve a long-standing problem, which is a safe, cost-effective, convenient and compliant disposal of unused medications including controlled substances.

The DEA issued new regulations in September of 2014, which were designed to help a number of industries. Our new MedSafe meets or exceeds requirements of the new DEA regulations and is aimed at the assisted living, long-term care, hospice, drug treatment, government and retail pharmacy businesses.

One last thing before I turn the call over to Brandon. We were pleased to announce the promotion of Dennis Halligan to VP of Marketing in late 2014. Over the past three years, Dennis has played a key role in developing and leading a first-class marketing initiative for our company. He first focused on our online and inside sales initiatives and ultimately he supports the entire sales effort which includes field sales, national accounts, and so on. His leadership efforts have proven to be an integral component of our success in revenue growth for our company. For example, sales from our inside and online sales channel have grown from $1.7 million in calendar year 2011 to $4.4 million in calendar 2014, an increase over 2.5X. He works extremely well with others, knows the business and drops everything he may be doing to support a sale.

Now, with that I'll turn the call over to Brandon, who'll provide an update on the new product launch, the sales team and a number of sales initiatives. Brandon?

Brandon Beaver – Senior Vice President of Sales

Thank you, David. I'd like to start by saying we have seen a tremendous interest in the marketplace for our MedSafe solutions since its launch in October of 2014. MedSafe is a growth opportunity for Sharps as it represents a solution for long-term care facilities, pharmacies, law enforcement, narcotic treatment programs, hospitals and clinics with onsite pharmacies, who are charged with finding a safe, compliant, convenient and cost effective means of disposing of unused medications including controlled substances. Disposal of controlled substances for these facilities prior to the DEA rule change could be very expensive and a bit archaic.

The product launch included inside and field sales efforts as well as significant web and traditional marketing initiatives designed to build awareness of the MedSafe offering among existing and prospective customers. Our extensive marketing efforts, coupled with our field sales team calls, have generated literally hundreds of inquiries from facilities with single locations, all the way up to large national chains. We believe the MedSafe solution represents one of the largest new product launches in the company's history.

As we cautioned last quarter this product is not an impulse-buy. It is a new product and a new protocol for the industry that prospective customers are researching carefully before buying, particularly since it involves controlled substances. However, we're excited about the interest that we have seen so far and believe we will be in a better position to comment on the industry adoption of the MedSafe in June 2015 quarter timeframe.

The new DEA regulations also created the opportunity for our TakeAway envelope solution and new box configurations which also facilitate the proper and cost effective disposal of unused medications including controlled substances. Over the past five years, Sharps has sold more than 1.5 million of the prior version of our TakeAway envelope solution. We believe the new systems could generate incremental revenue growth in many industries including retail, home-health, hospice, government and long-term care. We are already seeing interest in the new envelope in the retail and government sectors and believe the new offering will contribute to future revenue growth as early as the March 2015 quarter.

We've made a concentrated effort over the past few years to develop strong relationships in the pharmaceutical manufacturer market. Our unique offering goes beyond just providing disposal solutions for self-injecting patients in the home setting by providing opportunities for pharma branding and improved patient compliance and medication adherence. We've launched a number of new marketing initiatives aimed at identifying new prospects and landing new programs. We continue to be bullish regarding the long-term growth for this market.

Now let's move on to the sales organization. Our sales team is at 17 employees including inside, field, and support, compared to 14 employees at the beginning of calendar 2014, and 13 employees when I took over the sales group in October of 2013. We're actively working to add, at least three sales people to the team, primarily in the inside sales group. I'm confident these positions will be filled in the March quarter.

I believe we have the strongest and most experienced sales team in company history. We're already seeing new field sales opportunities close beginning in the December 2014 quarter, which positively impact revenue beginning in the March 2015 quarter. We're focused on closing additional new business throughout calendar year 2015. By the way, the majority of these new opportunities closed, as well as the prospects we're hoping to close in 2015, have some element of the offering that includes a Sharps-based pickup service in addition to the mailback. Our extensive route-based pickup network, which includes over 30 companies located across the country, in combination with our hazardous-waste network completes our comprehensive offering.

Finally, I want to reiterate what David said earlier about Dennis. Dennis and his team work extremely well with the sales organization. I believe his marketing efforts are a critical component of the company's sales success. I'll turn it back to you, David.

David Tusa – Chief Executive Officer and President
Thanks for the update, Brandon. Now, I'd like Diana to cover the financial section.

Diana Diaz – Vice President and Chief Financial Officer
Thank you, David. During the second quarter, the company reported revenue growth of 14% to $8.7 million as compared to $7.6 million in the second quarter of last year. Gross margin was 37% in the second quarter as compared to 35% in the prior year second quarter. The margin increase was driven by the leverage gained from higher revenue.

Selling, general and administrative expense or SG&A decreased to $2.4 million, or 28% of sales, as compared to $2.5 million, or 32% of sales in the second quarter of last year. SG&A in the second quarter of 2014 was negatively impacted by legal expenses of $157,000 associated with our claim to the CDC related to the termination of a government contract and by $102,000 of severance costs for a former officer of the company. SG&A in the second quarter of this year included increased sales and marketing spending as compared to the second quarter of last year.

The company reported operating income of $744,000, or an operating margin of 8.6% as compared to operating income of $120,000, or an operating margin of 1.6%, in the second quarter of fiscal 2014.

Sharps recorded EBITDA or earnings before interest, taxes, depreciation and amortization of $962,000 for the second quarter of fiscal 2015, as compared to EBITDA of $402,000 in the second quarter of last year.

The EBITDA margin was 11.1% for the second quarter of fiscal 2015, as compared to an EBITDA margin of 5.3% for the comparable period in the prior year.

Overall, the company generated net income of $749,000, or $0.05 per basic and diluted share this quarter, compared with net income of $120,000, or $0.01 per basic and diluted share in the second quarter of last year.

Now, looking at a few of the highlights for the six months ended December 31, 2014. Revenue of $15.7 million in the first 6 months of fiscal 2015 increased 13% compared to revenue of $13.9 million in the first 6 months of last year. Customer billings increased 16% to $16.2 million in the first half of fiscal 2015. Retail billings grew 37% to $5.1 million as compared to $3.7 million in the first 6 months of last year, primarily due to increases in flu shot related business. That flu business for the 6 months ended December 31, 2014 of $4.1 million was up 35% in comparison with the prior year period at $3 million. While this market is traditionally inconsistent quarter-to-quarter, the expansion of healthcare services in retail pharmacies overall drives growth for the company.

Pharmaceutical manufacturer billings increased 31% to $2.7 million in the first half of fiscal 2015, as compared to $2.1 million in the comparable period last year. Professional billings increased 14% to $3.2 million in the first 6 months of fiscal 2015, as compared to $2.8 million in the same prior year period.

Fiscal 2015 year-to-date gross margin was 35%, as compared to gross margin of 36% in the first 6 months of fiscal 2014. SG&A expense increased to $4.7 million in the first-half of fiscal 2015, an increase of 5% over the prior year period as a result of increased investments in sales and marketing initiatives. Operating income improved to about $700,000 in the first half of fiscal 2015, as compared to operating income of $250,000 in the first half of fiscal 2014.

EBITDA improved to $1.1 million in the first half of 2015, as compared to EBITDA of over $800,000 in the last year. Net income for the first 6 months of fiscal 2015 was $675,000, or $0.04 per basic and diluted share, compared to net income of almost $250,000, or $0.02 per basic and diluted share in the first 6 months of fiscal

2014. Our balance sheet remains solid with $16.4 million of cash and cash equivalents at December 31, 2014, compared to $13.7 million at June 30, 2014 with no debt. At December 31, 2014, working capital, stockholders equity and total assets were $18.9 million, $22.7 million and $28.2 million respectively. Inventory of $2.2 million at December 31, 2014, is higher than the balance at June 30, 2014 of $1.3 million and December 31, 2013, of $1.4 million. We have increased inventory levels to facilitate increased demand.

With that, I'll turn the call back over to David.

David Tusa – Chief Executive Officer and President
Thanks, Diana. Just a couple of statements before we turn the call over to the Q&A session. This was an excellent quarter for the company. We're very energized to continue this positive momentum, and we remain committed to growing the company significantly over the long-term through organic growth, new solutions and service offerings and potentially acquisitions.

With that, operator, let's go ahead and turn it over to questions.

Operator
Thank you. (Operator instructions.) Our first question comes from Joe Munda from Sidoti & Company.

<Q>: David, on the professional side, the growth you guys are seeing there, it's pretty impressive quarter-over-quarter. I'm just wondering, how much of that business is existing customer orders versus new customers? Could you give us a sense, were there new customers added, is that where we're seeing the bulk of the growth coming from?

David Tusa – Chief Executive Officer and President
Yes. We've done a pretty good job on the professional side with new customer growth. So I think a lot of it's new revenue— revenue from new customers, but there are reorders as well from existing customers.

<Q>: My next question is, I guess, for Brandon. Brandon, you are seeing home healthcare kind of stagnate here at this $1.7 million level. What are your plans going forward to kind of jumpstart growth there or is this our expectation going forward?

Brandon Beaver – Senior Vice President of Sales
We've seen a lot of consolidation in the market, the home and health market, really it's down to a handful of large national players with a number of individual locations, very similar to the long-term care market. Actually they almost mirror each other as far as the way they operate from top-down. So we've had a larger focus from our inside sales group going after a lot of the individual locations. We need to do a better job though, penetrating some of the larger ones. We do have some of their business but we need to grow that business internally. We have three out of the top four large chains from home health, but we need to penetrate them a little bit better. From an inside sales standpoint, we're making a concentrated effort to go after the single type locations that are out there, a very fragmented industry.

<Q>: And the new guy you brought on, Dennis— does he have experience in going after the home healthcare market?

Brandon Beaver – Senior Vice President of Sales
Dennis is doing a tremendous job of creating marketing initiatives throughout several, different marketplaces. He is creating ad campaigns. He's doing anything and everything from each individual market, so we can do it by sector, we can do it by geography. He is spending a lot of time in a couple of our key markets one being in home health.

<Q>: As far as MedSafe is concerned, the rollout, you guys talked about a number of inquiries that you are getting. I'm just wondering, has that actually translated into sales thus far? If so, can you give us some idea of what we're looking at?

David Tusa – Chief Executive Officer and President
It has translated to sales and to new contracts. I think we'll start to see some of the impact of that in the March quarter. But to be honest with you, for competitive reasons, because this is a new product and a new opportunity, we'll wait a couple of few quarters to talk more specifics.

<Q>: Does that go hand-in-hand with the new envelope that you guys were talking about as far as new opportunities are concerned?

David Tusa – Chief Executive Officer and President
It does and it doesn't. You have some facilities that are interested in the MedSafe that could also utilize the envelopes but the envelopes are different in that the envelopes can just be an opportunity either in retail pharmacy or potential government or healthcare related facility. So we've seen a significant interest in the new envelope, because it can now facilitate the disposal of controlled substances, which it could not in the past. Again, we think that over the next couple of quarters, we could see some incremental revenue from those products.

<Q>: I guess, my final question, as far as the pharma business is concerned, you're expecting three new programs you talked about. Looking for modeling purposes here, are we looking at $1.3 million a quarter or do we see a ramp-up heading into fiscal 2016?

Diana Diaz – Vice President and Chief Financial Officer
If we look at all these new programs together as they roll out, the annual revenue impact once they're fully rolled out would be somewhere between $2 million to $3.5 million.

David Tusa – Chief Executive Officer and President
That's a lumpy business as well, because it's bulk orders into a vendor-managed inventory system. So with that, I think, it's important to look at that more from a, kind of a trailing 12 month standpoint. You really have to look at it over a period of time. But we continue to launch new programs and I know, that Brandon is working with Dennis in trying to uncover some additional opportunities through a number of marketing areas, and we have field salespeople that are calling on that market as well. So, it's a longer sales cycle, because they're larger deals and they're lumpy, but from the long-term perspective we're still bullish on that market.

Operator
Our next question comes from Kevin Steinke from Barrington Research.

<Q>: I wanted to circle back on the professional market, you did have good growth there. Brandon, I think, on last quarter's call, you mentioned that you were also going to have the inside salespeople, not only going after individual locations, but also trying to target some, say, 10 to 20 facility-size chains. Can you talk about that effort, and if that's contributed to growth at all here?

Brandon Beaver – Senior Vice President of Sales
Sure, thanks, Kevin. You're exactly right. The inside sales is predominantly going for anything between one and up to 50 locations internally, and that can be long-term care, it could be professional, it could be your home

health, even retailIn this December quarter, we've had some significant success, multiple chains, what I call chains that are 50 and under have been closed.

As David mentioned earlier, we'll start to reap some of those rewards in the March quarter. I'm thinking specifically of a long-term care chain or two that was closed as well as a retail chain. So, you'll start to see even more of that in this next quarter from everything from MedSafe to just our standard mailbacks.

<Q>: So it sounds like inside sales getting some good momentum here, is that the reasoning for looking to add more people here? I think you said, what, three more you are looking to add?

Brandon Beaver – Senior Vice President of Sales
Yes, that's right. From Dennis' traditional marketing initiatives, from web to our chat service, we're receiving a lot of inbound opportunities, which is phenomenal. These are opportunities that have a high level of closing and so we're at the point now where we need to add additional resources to handle that capacity. But also to reach out we need to be doing some outbound sales. So we're becoming stretched, and at this juncture, we think it's time to add some new bodies.

<Q>: Obviously a really strong quarter in retail helped by or driven by the flu shot season. In past March quarters, you've seen some carry-through on the flu season into the March quarter, and also you've had advance orders for the upcoming flu season in the March quarter. Are you seeing either of those two dynamics playing out thus far as you look into results for the current quarter?

David Tusa – Chief Executive Officer and President
Kevin, it's difficult to say, that's why we look at our markets, over more of an annual period. Sometimes they will order up in March; sometimes it's June. It's really too difficult to predict, and we really focus more on an annual period.

<Q>: And the new patient support program that you launched this quarter, you said it was for a new drug. So was that a new drug at an existing pharmaceutical manufacturer customer?

Brandon Beaver – Senior Vice President of Sales
Kevin, it was an existing manufacturer that we've had a longstanding relationship with that launched a new FDA approved drug that we are excited about.

<Q>: So, that kind of leads to my next question is that it's encouraging to see that you have new deals in the pipeline that you're looking to roll out over calendar 2015 and 2016. But in addition to new customer prospects, what would you say is the opportunity to just further penetrate existing pharma manufacturer customers, as they roll out new drugs? I mean, that would seem to be a good area to attack, you already have the customer relationship in place.

Brandon Beaver – Senior Vice President of Sales
We pride ourselves on the Sharps solution for our pharma manufacturer programs as not just being a disposal program, really it's a program that provides data, adherence data, everything from adherence to compliance. We have over the last couple of quarters really started working closely with the manufacturers on this data. Really what we are doing here, Kevin, is identifying patients that are either potentially not using the drug the way they should be, or going off of service. What this does, once we provide this data back to the manufacturers, they are able to then utilize this as a kind of a touch point back to the patient. So, we feel with this increased leverage with data, that it ultimately will provide additional dollars with additional volume.

David Tusa – Chief Executive Officer and President

Let me add to that, Kevin. We have a couple of pharma manufacturer customers, where we have penetrated into other drugs. And some pharmaceutical manufacturers, you have to call on each individual product manager, and some of them really have more of a corporate, company-wide initiative, so it depends on the pharma manufacturer. I know a couple of them, in particular, where I think Brandon and his team have done a great job in bringing new drugs and programs online.

Operator
Thank you. (Operator instructions.) Our next question comes from Brian Butler from Stifel.

<Q>: First question, just at the end of calendar year 2014, there were a couple of requests of information coming out of the VA, as well as, I think, the Department of Defense. I was wondering if you have any color or any feedback that you've gotten from those agencies on those RFIs, and whether they might be moving to some type of RFP process.

David Tusa – Chief Executive Officer and President
Good question, Brian, but we try not to talk about any prospects or anything that we haven't completed. We like to talk about deals after they're done but over the years, we've chased a number of government opportunities. And if it makes sense, we'll participate, but I think at this point, we'll just leave it at that and say that we won't comment on potential prospects until they're done.

<Q>: And then on the environmental piece or segment that you have, that looked like that was on the low side for the quarter. Obviously, that's going to be a choppy type business but do you have any color on that segment and what your thoughts are for the remainder of your fiscal 2015?

David Tusa – Chief Executive Officer and President
It's really almost like project by project. We had a couple of good quarters, where we had some third-party incineration activity that was as much as $150,000 or $200,000 and we're chasing a number of the larger opportunities and it's lumpy. So I know there are some that are out there. It's really difficult to predict what quarter they're going to fall into but we're hopeful for the calendar year 2015 that we'll land a couple of larger deals and you'll see those numbers potentially larger.

<Q>: Then just the last question, when it comes to kind of capital deployment, are there any opportunities, internally or externally, that you guys are really looking at for kind of using some of the capital you have on the balance sheet?

David Tusa – Chief Executive Officer and President
We're looking into a number of things and we've been pretty active over the last year and seeing if there's additional products or services that we can introduce, that we can sell into the existing or the prospective customer base. So we are working on a number of thingsand, again, I like to report on those when they get done. But it's important as we do any kind of spending of the capital, that it's done in a prudent manner where we think we're going to get a significant ROI and where there's little integration risk and where we can truly provide additional products and services to service our customers.

<Q>: These programs under consideration, are these kind of like fiscal 2015, where you hope to come to a decision, or is that really much just longer kind of open-ended?

David Tusa – Chief Executive Officer and President
I would hope that during, I'll say the calendar 2015, but maybe even fiscal year 2015, we could see some come to fruition and we're actively working on a number of initiatives, but they've got be right.

Operator
Thank you. Our next question comes from George Walsh from Gilford Securities.

<Q>: David, do you have any data with this last flu season in terms of the percentages of people getting their shots that are going into the retail pharmacies versus the more traditional sources, and how that's growing and the trends you see there?

David Tusa – Chief Executive Officer and President
We don't have exact numbers, I think last year, we were up to 20% to 22% of flu shots were administered in the retail setting. We know it's higher than that, I haven't seen any updated data. What's so unique about this market for us is that we have a good handle on that market, and it grows every year, because more and more flu shots and year-round shots and other immunizations are administered in that alternate site setting. But I wouldn't be surprised, George, if it didn't go from 20% to maybe even 24%, 25%.

<Q>: I mean, you see the signs all the time, obviously, during flu season with the retail chains. Are there other aggressive marketing or more aggressive marketing moves that the chains are taking, because obviously it drives traffic into their stores?

David Tusa – Chief Executive Officer and President
It does. You see the retail pharmacies moving more and more into healthcare and I think it's a growing trend. If you look at the stats on the number of clinics and retail pharmacies, they just continue to grow and grow significantly. We are proud of the penetration that we've made into that market and we're proud of the fact that the mailback solution is seen as very cost effective and operationally efficient for these retail clinics.

Operator
Thank you. At this time, I'll turn the call back over to management for closing comments.

David Tusa – Chief Executive Officer and President
Thank you, everyone, for participating in the call. We appreciate your support, and we look forward to talking to you next quarter.