STERICYCLE INC
Form 10-K
March 01, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(MARK ONE)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM TO

Commission File Number 0-21229

Stericycle, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	**36-3640402**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification Number)**

28161 North Keith Drive

Lake Forest, Illinois 60045

(Address of Principal Executive Offices including Zip Code)

(847) 367-5910

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.01 par value

(title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Act of 1934. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. x

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of voting and non-voting common equity held by non-affiliates computed by reference to the price at which common equity was last sold as of the last business day of the registrant s most recently completed second fiscal quarter (June 30, 2006) was: $2,771,381,279.

On February 22, 2007, there were 44,316,672 shares of the Registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Information required by Items 10, 11, 12 and 13 of Part III of this Report is incorporated by reference from the Registrant s definitive Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on May 16, 2007.

Table of Contents

Stericycle, Inc.

2006 ANNUAL REPORT ON FORM 10-K

INDEX

Table of Contents

PART I

Item 1. Business

Unless the context requires otherwise, we, us or our refers to Stericycle, Inc. and its subsidiaries on a consolidated basis.

Overview

We are in the business of managing regulated waste and providing an array of related services. We operate in the United States, Canada, Mexico, the United Kingdom, Ireland and Argentina.

For large-quantity generators of regulated waste such as hospitals and for pharmaceutical companies and distributors, we offer:

- our institutional regulated waste management services
- our *Bio Systems*® sharps management services to reduce the risk of needle sticks
- a variety of products and services for infection control
- our regulated returns management services for expired or recalled healthcare products

For small-quantity generators of regulated waste such as doctors offices and for retail pharmacies, we offer:

- our regulated waste management services
- our *Steri-Safe*® Occupational Safety and Health Act and Health Insurance Portability and Accountability Act (HIPAA) compliance programs
- a variety of products and services for infection control
- our regulated returns management services for expired or recalled healthcare products

We operate integrated national regulated waste management networks in the United States, Canada, Mexico, Argentina, the United Kingdom and Ireland. Our national networks include a total of 76 processing or combined processing and collection sites and 104 additional transfer, collection or combined transfer and collection sites.

Our regulated waste processing technologies include autoclaving, our proprietary electro-thermal-deactivation system (ETD), chemical treatment and incineration.

We serve approximately 351,700 customers worldwide, of which approximately 8,600 are large-quantity generators, such as hospitals, blood banks and pharmaceutical manufacturers, and approximately 343,100 are small-quantity generators, such as outpatient clinics, medical and dental offices, long-term and sub-acute care facilities and retail pharmacies.

We benefit from significant customer diversification. No one customer accounts for more than 2% of our total revenues, and our top 10 customers account for approximately 9% of total revenues.

Industry Overview

Governmental legislation and regulation increasingly requires the proper handling and disposal of regulated waste. Regulated medical waste is generally any medical waste that can cause an infectious disease, and includes: single-use disposable items, such as needles, syringes, gloves and other medical supplies; cultures and stocks of infectious agents; and blood and blood products. Regulated pharmaceutical waste consists of expired or recalled pharmaceuticals.

Table of Contents

We believe that the United States market for regulated waste and compliance services of the type that we provide is approximately $3.5 billion and that the market is in excess of $10.0 billion worldwide. Industry growth is driven by a number of factors. These factors include:

Aging of U.S. Population. The average age of the U.S. population is rising. As people age, they typically require more medical attention and a wider variety of tests, procedures and medications, leading to an increase in the quantity of regulated waste generated.

Pressure To Reduce Healthcare Costs. The healthcare industry is under pressure to reduce costs. We believe that our services can help healthcare providers to reduce their handling and compliance costs and to reduce their potential liability for employee exposure to blood-borne pathogens and other infectious agents.

Environmental and Safety Regulation. We believe that many businesses that are not currently using third party regulated waste services are unaware either of the need for proper training of employees or of the requirements of the Occupational Safety and Health Administration (OSHA) regarding the handling of regulated waste. These businesses include manufacturing facilities, schools, restaurants, hotels and other businesses where employees may come into contact with blood-borne pathogens. Similarly, the proper handling of expired or recalled pharmaceuticals requires an expertise that many retail pharmacies lack or find inefficient to provide.

Shift to Off-Site Treatment. We believe that patient care is continuing to shift from institutional higher-cost acute-care settings to less expensive, smaller, off-site treatment alternatives, with a resulting increase in the number of regulated waste generators that cannot treat their own regulated waste.

Control of Drug Diversion. The U.S. Drug Enforcement Administration (DEA) has recently emphasized improved control of the handling and shipment of controlled substances to prevent diversion and counterfeiting, thus increasing the utility to pharmaceutical manufacturers and distributors of a returns service for expired or recalled pharmaceuticals.

Competitive Strengths

We believe that we benefit from the following competitive strengths, among others:

Broad Range of Services. We offer our customers a broad range of services to help them develop systems and processes to manage their regulated waste safely and efficiently. For example, we have developed programs to help our customers ensure and maintain compliance with OSHA and HIPAA regulations.

Established National Network. We believe that a network like ours would be very expensive and time-consuming for a competitor to develop.

Diverse Customer Base and Revenue Stability. We have a very diverse customer base in all the markets in which we operate. We are also generally protected from the cost of regulatory changes and increases in fuel, insurance and other operating costs because our regulated waste contracts typically allow us to adjust our prices to reflect these cost increases.

Strong Sales Network and Proprietary Database. We use both telemarketing and direct sales efforts to obtain new regulated waste customers. In addition, we have a large database of potential new small-quantity customers, which we believe gives us a competitive advantage in identifying and reaching this higher-margin sector.

Experienced Senior Management Team. We have experienced leadership. Our six most senior executives collectively have over 150 years of management experience in the health care, consumer and waste management industries.

Ability To Integrate Acquisitions. We have completed 116 acquisitions since 1993 and have demonstrated a consistent ability to integrate our acquisitions into our operations successfully.

Table of Contents

Business Strategy

Our goals are to strengthen our position as a leading provider of regulated waste and compliance services and to continue to improve our profitability. Components of our strategy to achieve these goals include:

- ***Expand Range of Services and Products***. We believe that we continue to have opportunities to expand our business by increasing the range of products and services that we offer our existing regulated waste customers. For example, through our *Steri-Safe®* program, we now offer OSHA compliance services to small-quantity customers, and an acquisition in 2003 enabled us to market the *Bio Systems®* sharps management program to large-quantity customers in new geographic areas. We have expanded our regulated waste services to pharmaceutical companies and other large-quantity generators through a series of acquisitions in 2005 and 2006 of five businesses engaged in regulated returns management services.

- ***Improve Margins***. We intend to continue working to improve our margins by increasing our base of small-quantity customers and focusing on service strategies that more efficiently meet the needs of our large-quantity customers. We have succeeded in raising the percentage of our revenues from small-quantity customers from 33% of domestic revenues in the fourth quarter of 1996 to 62% in the fourth quarter of 2006.

- ***Seek Complementary Acquisitions***. We intend to continue to seek opportunities to acquire businesses that expand our national networks in the United States and internationally and increase our customer base. We believe that selective acquisitions can enable us to improve our operating efficiencies through increased utilization of our service infrastructure.

Acquisitions

We have substantial experience in evaluating potential acquisitions and determining whether a particular waste business can be integrated into our operations with minimal disruption. Once a business is acquired, we implement programs and procedures to improve customer service, sales, marketing, routing, equipment utilization, employee productivity, operating efficiency and overall profitability.

We completed 116 acquisitions from 1993 through 2006, with 89 in the United States and 27 internationally.

During 2006, we completed 16 acquisitions, with seven in the United States, one in Canada, six in Mexico, one in Ireland, and one in Argentina.

Services and Operations

Collection and Transportation. In many respects, our regulated waste business is one of logistics. Efficiency of collection and transportation of regulated waste is a critical element of our operations because it represents the largest component of our operating costs.

For regulated waste, we supply specially designed reusable leak-and puncture-resistant plastic containers to most of our large-quantity customers and many of our larger small-quantity customers. To assure regulatory compliance, we will not accept regulated waste from customers unless it is properly packaged in containers that we have either supplied or approved.

We collect containers or corrugated boxes of regulated waste from our customers at intervals depending upon customer requirements, contract terms and volume of waste generated. The waste is then transported directly to one of our processing facilities or to one of our transfer stations where it is combined with other regulated waste and transported to a processing facility.

Transfer stations allow us to temporarily hold small loads of waste until they can be consolidated into full truckloads and transported to a processing facility. Our use of transfer stations in a hub and spoke configuration improves the efficiency of our collection and transportation operations by expanding the geographic area that a particular processing facility can serve and thereby increasing utilization of the facility by increasing the volume of waste that it processes.

We collect some expired or recalled pharmaceuticals from pharmacy shelves but more typically, pharmacies ship them directly to our processing facilities.

Processing and Disposal. Upon arrival at a processing facility, containers or boxes of regulated waste are typically scanned to verify that they do not contain any unacceptable substances like radioactive material. Any container or box that is discovered to contain unacceptable waste is returned to the customer and the appropriate regulatory authorities are informed.

The regulated waste is then processed using one of our various treatment technologies. Upon completion of the particular process, the resulting waste or incinerator ash is transported for resource recovery, recycling or disposal in a landfill operated by an unaffiliated third party. We do not own any landfills. After plastic containers such as our *Steri-Tub®* or *Bio Systems®* containers have been emptied, they are washed, sanitized and returned to customers for re-use.

Upon receipt at a processing facility, expired or recalled pharmaceuticals are counted and logged, and controlled substances are stored securely. In accordance with the manufacturer s instructions, expired or recalled pharmaceuticals are then returned to the manufacturer or destroyed in compliance with applicable regulations.

Documentation. We provide complete documentation to our customers for all regulated waste that we collect in accordance with applicable regulations and customer requirements.

Marketing and Sales

Marketing Strategy. We use both telemarketing and direct sales efforts to obtain new customers. In addition, our drivers may also participate in our regulated waste marketing efforts by actively soliciting small-quantity customers they service.

Small-Quantity Customers. We target small-quantity customers as a growth area of our regulated waste business. We believe that small-quantity regulated waste customers view the potential risks of failing to comply with applicable state and federal regulated waste regulations as disproportionate to the cost of the services that we provide. We believe that this factor has been the basis for the significantly higher gross margins that we have achieved with our small-quantity customers relative to our large-quantity customers. We believe that the same potential exists in processing returns of expired pharmaceuticals for smaller retail pharmacies.

Steri-Safe®. Our *Steri-Safe®* OSHA compliance program provides an integrated regulated waste management and compliance-assistance service for small-quantity customers who typically lack the internal personnel and systems to comply with OSHA blood-borne regulations. Customers for our *Steri-Safe®* service pay a predetermined subscription fee in advance for regulated waste collection and processing services and can also choose from available packages of training and education services and products designed to help them to comply with OSHA regulations. Approximately 105,000 small-quantity customers are enrolled in this program. We believe that the implementation of our *Steri-Safe®* service provides us with an enhanced opportunity to leverage our existing customer base through the program s prepayment structure and diversified product and service offerings.

Mail-Back Program. We also operate a mail-back program by which we can reach small-quantity regulated waste customers located in outlying areas that would be inefficient to serve using our regular route structure. Mail-back programs are also used in home care patient settings.

Large-Quantity Customers. Our marketing efforts to large-quantity customers are conducted by account executives that are also able to provide consulting services to assist our large-quantity customers in training their employees on safety issues and implementing programs to improve waste segregation.

Our *Bio Systems*® sharps management offering can enhance our revenue and margins per large-quantity account. The *Bio Systems*® service can help our large-quantity customers eliminate plastic and cardboard from their waste stream while providing a safe and cost-effective way for them to deal with the disposal of their sharp objects (such as needles, syringes, etc.).

We offer hospital pharmacies an onsite collection service to assist them in accounting for and segregating expired or recalled pharmaceuticals.

National Accounts. As a result of our extensive geographic coverage, we are capable of servicing national account customers (i.e., customers requiring regulated waste services at various geographically dispersed locations).

Contracts. We have multi-year contracts with a large majority of our customers. We negotiate individual contracts with each large-quantity and small-quantity customer. Although we have a standard form of contract, particularly for small-quantity customers, terms may vary depending upon the customer s service requirements and the volume of regulated waste generated and, in some jurisdictions, statutory and regulatory requirements. Substantially all of our contracts with small-quantity customers contain automatic renewal provisions.

International

We conduct regulated waste operations in Canada, Mexico, Argentina, the United Kingdom and Ireland as well as the United States. We began our operations in Canada and Mexico in 1998, in Argentina in 1999, in the United Kingdom in 2004 and in Ireland in 2006.

Processing Technologies

We currently use both non-incineration technologies (autoclaving, chemical treatment and our proprietary ETD technology) and incineration technologies for treating regulated waste.

Stericycle was founded on the belief that there was a need for safe, secure and environmentally responsible management of regulated waste. From our beginning we have championed the use of non-incineration treatment technologies such as our ETD process. While we recognize that some state regulations currently in force mandate that some types of regulated waste must be incinerated, we also know from years of experience working with our customers that there are ways to reduce the amount of regulated waste that is ultimately incinerated. The most effective strategy that we have seen involves comprehensive education of our customers in waste minimization and segregation. Working in cooperation with our customers, we have made tremendous strides in moving away from incineration and towards alternate treatment technologies. At the end of 2006, incineration constituted less than 8% of our treatment capacity in the United States, Canada and Mexico.

Autoclaving. Autoclaving treats regulated waste with steam at high temperature and pressure to kill pathogens. Autoclaving alone does not change the appearance of waste, and some landfill operators may not accept recognizable regulated waste, but autoclaving may be combined with a shredding or grinding process to render the regulated waste unrecognizable.

ETD. Our ETD treatment process includes a system for grinding regulated waste. After grinding, ETD uses an oscillating field of low-frequency radio waves to heat regulated waste to temperatures that destroy pathogens such as viruses, bacteria, fungi and yeast without melting the plastic content of the waste. ETD does not produce regulated air or water emissions.

Table of Contents

Incineration. Incineration burns regulated waste at elevated temperatures and reduces it to ash. Incineration reduces the volume of waste, and it is the recommended treatment and disposal option for some types of regulated waste such as anatomical waste or residues from chemotherapy procedures. Air emissions from incinerators can contain certain byproducts that are subject to federal, state and, in some cases, local regulation. In some circumstances, the ash byproduct of incineration may be regulated.

Chem-Clav. Chemclaving treats regulated waste using high heat, pressure, and a steam auger to kill pathogens. The waste is treated in a sealed container while the auger shreds the waste, making it unrecognizable while exposing more surface area of the waste to the steam. After shredding and treatment, the waste residue is sterile and safe for landfill.

Competition

The regulated waste industry is highly competitive, and barriers to entry into the regulated waste collection and disposal business and the pharmaceutical returns business are very low. Our competitors consist of many different types of service providers, including a large number of regional and local companies. In the regulated waste industry, another major source of competition is the on-site treatment of regulated waste by some large-quantity generators, particularly hospitals.

In addition, in the regulated waste industry we face potential competition from businesses that are attempting to commercialize alternate treatment technologies or products designed to reduce or eliminate the generation of regulated waste, such as reusable or degradable medical products.

Governmental Regulation

The regulated waste industry is subject to extensive and frequently changing federal, state and local laws and regulations. This statutory and regulatory framework imposes a variety of compliance requirements, including requirements to obtain and maintain government permits. These permits grant us the authority, among other things:

- to construct and operate collection, transfer and processing facilities,
- to transport regulated waste within and between relevant jurisdictions, and
- to handle particular regulated substances.

Our permits must be periodically renewed and are subject to modification or revocation by the issuing authority.

We are also subject to regulations that govern the definition, generation, segregation, handling, packaging, transportation, treatment, storage and disposal of regulated waste. We are also subject to extensive regulations designed to minimize employee exposure to regulated waste.

Domestic Federal Regulation. Five federal agencies have authority over regulated waste. These agencies are the U.S. Environmental Protection Agency (EPA), Occupational Safety and Health Administration (OSHA), U.S. Department of Transportation (DOT), the U.S. Postal Service (USPS) and the U.S. Drug Enforcement Administration (DEA). These agencies supervise regulated waste under a variety of statutes and regulations. The principal statutes and regulations are:

- *Medical Waste Tracking Act of 1988*. In the late 1980s, the EPA outlined a two-year demonstration program pursuant to the Medical Waste Tracking Act (MWTA), which was added to the Resource Conservation and Recovery Act of 1976. In regulations implementing the MWTA, the EPA defined medical waste and established guidelines for its segregation, handling, containment, labeling and transport. The MWTA demonstration program expired in 1991, but the MWTA established a model followed by many states in developing their specific medical waste regulatory framework.

Table of Contents

Occupational Safety and Health Act of 1970. The Occupational Safety and Health Act of 1970 authorizes OSHA to issue occupational safety and health standards. Various standards apply to certain aspects of our operations and govern such matters as exposure to blood borne pathogens and other potentially infectious materials.

Resource Conservation and Recovery Act of 1976. The Resource Conservation and Recovery Act of 1976 (RCRA) created standards for the generation, transportation, treatment, storage and disposal of solid and hazardous wastes. Medical wastes are currently considered non-hazardous solid wastes under RCRA. However, some substances collected by us from some of our customers, including photographic fixer developer solutions, lead foils and dental amalgam, are considered hazardous wastes.

Clean Air Act Regulations. In August 1997, the EPA adopted regulations under the Clean Air Act Amendments of 1990 that limit the discharge into the atmosphere of pollutants released by regulated waste incineration. These regulations required every state to submit to the EPA for approval a plan to meet minimum emission standards for these pollutants. We currently operate seven incinerators in the United States. We believe these incinerators are in compliance with applicable state requirements.

DOT Regulations. DOT has adopted regulations under the Hazardous Materials Transportation Authorization Act of 1994 that require us to package and label regulated waste in compliance with designated standards, and which incorporate blood borne pathogens standards issued by OSHA. Under these standards, we must, among other things, identify our packaging with a biohazard marking on the outer packaging, and our regulated waste container must be sufficiently rigid and strong to prevent tearing or bursting. It must also be puncture-resistant, leak-resistant, properly sealed and impervious to moisture.

Expired or recalled pharmaceuticals are subject to the substantially same DOT regulations as medical waste. We identify these products by their National Drug Code number and classify them by their handling, transportation and disposal requirements.

Comprehensive Environmental Response, Compensation and Liability Act of 1980. The Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, established a regulatory and remedial program to provide for the investigation and cleanup of facilities that have released or threaten to release hazardous substances into the environment. CERCLA and state laws similar to it may impose strict, joint and several liability on the current and former owners and operators of facilities from which releases of hazardous substances have occurred and on the generators and transporters of the hazardous substances that come to be located at these facilities.

USPS Regulations. We have obtained permits from the USPS to conduct our mail-back program, pursuant to which customers mail approved containers of sharps (needles, knives, broken glass and the like) directly to our treatment facilities.

Controlled Substances Act. Our returns service for expired and recalled pharmaceuticals is required to comply with DEA regulations relating to the approval and permitting of processing facilities, management of employees engaged in the collection, processing and disposal of controlled substances, proper documentation and reporting to the DEA.

We use landfills owned and operated by unrelated third parties for the disposal of waste from our processing facilities.

Domestic State and Local Regulation. We conduct business in 49 states and Puerto Rico. Each state has its own regulations related to the handling, treatment and storage of regulated waste. Although there are many differences among the various state laws and regulations, for regulated waste many states have followed the model under the MWTA and have implemented programs under RCRA. In each state where we operate a processing facility or a transfer station, we are required to comply with numerous state and local laws and

Table of Contents

regulations as well as our operating plan for each site. In addition, many local governments have ordinances and regulations, such as zoning and health regulations that affect our operations.

We maintain numerous governmental permits and licenses to conduct our business. Our permits vary from state to state based upon our activities within that state and on the applicable state and local laws and regulations.

Foreign Regulation. We are subject to substantial regulation by the governments of the foreign jurisdictions in which we conduct regulated waste operations. The statutory and regulatory requirements vary from jurisdiction to jurisdiction.

Patents and Proprietary Rights

We consider the protection of our technology to be important to our business. Our policy is to protect our technology by a variety of means, including applying for patents in the United States and in other foreign countries.

We hold 14 United States patents relating to the ETD treatment process and other aspects of processing regulated waste. We have filed or have been assigned patent applications in several foreign countries and we have received patents in Australia, Canada, France, Mexico, Japan, South Korea, Brazil, Denmark, Italy, South Africa, Spain, Sweden and the United Kingdom.

The term of the first-to-end of our existing United States patents relating to our ETD treatment process will currently end in May 2009 and the term of the last-to-end will currently end in January 2019.

We own federal registrations of the trademarks Steri-Fuel®, Steri-Plastic®, Steri-Tub®, Direct Return®, Steri-Safe®, the service mark Stericycle® and a service mark consisting of a nine-circle design.

Potential Liability and Insurance

The regulated waste industry involves potentially significant risks of statutory, contractual, tort and common law liability claims. Potential liability claims could involve, for example:

- cleanup costs;
- personal injury;
- damage to the environment;
- employee matters;
- property damage; or
- alleged negligence or professional errors or omissions in the planning or performance of work.

We could also be subject to fines or penalties in connection with violations of regulatory requirements.

We carry $35 million of liability insurance (including umbrella coverage), and under a separate policy, $10 million of aggregate pollution and legal liability insurance ($5 million per incident), which we consider sufficient to meet regulatory and customer requirements and to protect our employees, assets and operations

Employees

As of December 31, 2006, we had 5,035 full-time and 219 part-time employees, of which 3,747 were employed in the United States and 1,507 internationally. Approximately 324 of our U.S. drivers, transportation helpers and plant workers are covered by a total of eight collective bargaining agreements with local unions of the International Brotherhood of Teamsters. These agreements expire at various dates from April 2007 to November 2010. We consider our employee relations to be satisfactory.

Table of Contents

Website Access

We maintain an Internet website, *www.stericycle.com*, providing a variety of information about us. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, that we file with the Securities and Exchange Commission are available, as soon as reasonably practicable after filing, at the investors page on our website, *www.stericycle.com/investor.htm*, or by a direct link to our filings on the SEC s free website, *www.sec.gov*.

Item 1A. Risk Factors

We are subject to extensive governmental regulation, which is frequently difficult, expensive and time-consuming to comply with.

The regulated waste management industry is subject to extensive federal, state and local laws and regulations relating to the collection, transportation, packaging, labeling, handling, documentation, reporting, treatment and disposal of regulated waste. Our business requires us to obtain many permits, authorizations, approvals, certificates or other types of governmental permission from every jurisdiction where we operate. We believe that we currently comply in all material respects with all applicable permitting requirements. State and local regulations change often, however, and new regulations are frequently adopted. Changes in the regulations could require us to obtain new permits or to change the way in which we operate under existing permits. We might be unable to obtain the new permits that we require, and the cost of compliance with new or changed regulations could be significant.

Many of the permits that we require, especially those to build and operate processing plants and transfer facilities, are difficult and time-consuming to obtain. They may also contain conditions or restrictions that limit our ability to operate efficiently, and they may not be issued as quickly as we need them (or at all). If we cannot obtain the permits that we need when we need them, or if they contain unfavorable conditions, it could substantially impair our operations and reduce our revenues.

The handling and treatment of regulated waste carries with it the risk of personal injury to employees and others.

Our business requires us to handle materials that may be infectious or hazardous to life and property in other ways. While we try to handle such materials with care and in accordance with accepted and safe methods, the possibility of accidents, leaks, spills, and acts of God always exists. Examples of possible exposure to such materials include:

- truck accidents;
- damaged or leaking containers;
- improper storage of regulated waste by customers;
- improper placement by customers of materials into the waste stream that we are not authorized or able to process, such as certain body parts and tissues; or
- malfunctioning treatment plant equipment.

Human beings, animals or property could be injured, sickened or damaged by exposure to regulated waste. This in turn could result in lawsuits in which we are found liable for such injuries, and substantial damages could be awarded against us.

While we carry liability insurance intended to cover these contingencies, particular instances may occur that are not insured against or that are inadequately insured against. An uninsured or underinsured loss could be substantial and could impair our profitability and reduce our liquidity.

11

The handling of regulated waste exposes us to the risk of environmental liabilities, which may not be covered by insurance.

As a company engaged in regulated waste management, we face risks of liability for environmental contamination. The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, and similar state laws impose strict liability on current or former owners and operators of facilities that release hazardous substances into the environment as well as on the businesses that generate those substances and the businesses that transport them to the facilities. Responsible parties may be liable for substantial investigation and clean-up costs even if they operated their businesses properly and complied with applicable federal and state laws and regulations. Liability under CERCLA may be joint and several, which means that if we were found to be a business with responsibility for a particular CERCLA site, we could be required to pay the entire cost of the investigation and clean-up even though we were not the party responsible for the release of the hazardous substance and even though other companies might also be liable.

Our pollution liability insurance excludes liabilities under CERCLA. Thus, if we were to incur liability under CERCLA and if we could not identify other parties responsible under the law whom we are able to compel to contribute to our expenses, the cost to us could be substantial and could impair our profitability and reduce our liquidity. Our customer service agreements make clear that the customer is responsible for making sure that only appropriate materials are disposed of. If there were a claim against us that a customer might be legally liable for, we might not be successful in recovering our damages from the customer.

The level of governmental enforcement of environmental regulations has an uncertain effect on our business and could reduce the demand for our services.

We believe that the government s strict enforcement of laws and regulations relating to regulated waste collection and treatment has been good for our business. These laws and regulations increase the demand for our services. A relaxation of standards or other changes in governmental regulation of regulated waste could increase the number of competitors or reduce the need for our services.

If we are unable to acquire other regulated waste businesses, our revenue and profit growth may be slowed.

Historically our growth strategy has been based in substantial part on our ability to acquire other regulated waste businesses. We do not know whether in the future we will be able to:

- identify suitable businesses to buy;
- complete the purchase of those businesses on terms acceptable to us;
- improve the operations of the businesses that we do buy and successfully integrate their operations into our own; or
- avoid or overcome any concerns expressed by regulators.

We compete with other potential buyers for the acquisition of other regulated waste companies. This competition may result in fewer opportunities to purchase companies that are for sale. It may also result in higher purchase prices for the businesses that we want to purchase.

We also do not know whether our growth strategy will continue to be effective. Our business is significantly larger than before, and new acquisitions may not have the desired benefits that we have obtained in the past.

The implementation of our acquisition strategy could be affected in certain instances by the concerns of state regulators, which could result in our not being able to realize the full synergies or profitability of particular acquisitions.

We may become subject to inquiries and investigations by state antitrust regulators from time to time in the course of completing acquisitions of other regulated waste businesses. In order to obtain regulatory clearance for

a particular acquisition, we could be required to modify certain operating practices of the acquired business or to divest ourselves of one or more assets of the acquired business. Changes in the terms of our acquisitions required by regulators or agreed to by us in order to settle regulatory investigations could impede our acquisition strategy or reduce the anticipated synergies or profitability of our acquisitions. The likelihood and outcome of inquiries and investigations from state regulators in the course of completing acquisitions cannot be predicted.

Aggressive pricing by existing competitors and the entrance of new competitors could drive down our profits and slow our growth.

The regulated waste industry is very competitive because of low barriers to entry, among other reasons. This competition has required us in the past to reduce our prices, especially to large account customers, and may require us to reduce our prices in the future. Substantial price reductions could significantly reduce our earnings.

We face direct competition from a large number of small, local competitors. Because it requires very little money or technical know-how to compete with us in the collection and transportation of regulated waste, there are many regional and local companies in the industry. We face competition from these businesses, and competition from them is likely to exist in the new locations to which we may expand in the future. In addition, large national companies with substantial resources may decide to enter the regulated waste industry. For example, Waste Management, Inc., a major solid waste treatment company, announced in February 2005 that it intended to begin offering regulated waste management services to hospitals and possibly other large quantity generators of regulated waste.

Our competitors could take actions that would hurt our growth strategy, including the support of regulations that could delay or prevent us from obtaining or keeping permits. They might also give financial support to citizens groups that oppose our plans to locate a treatment or transfer facility at a particular location.

Restrictions in our senior unsecured credit facility may limit our ability to pay dividends, incur additional debt, make acquisitions and make other investments.

Our senior unsecured credit facility contains covenants that restrict our ability to make distributions to stockholders or other payments unless we satisfy certain financial tests and comply with various financial ratios.

It also contains covenants that limit our ability to incur additional indebtedness, acquire other businesses and make capital expenditures, and imposes various other restrictions. These covenants could affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise.

The loss of our senior executives could affect our ability to manage our business profitably.

We depend on a small number of senior executives. Our future success will depend upon, among other things, our ability to keep these executives and to hire other highly qualified employees at all levels. We compete with other potential employers for employees, and we may not be successful in hiring and keeping the executives and other employees that we need. We do not have written employment agreements with any of our executive officers, and officers and other key employees could leave us with little or no prior notice, either individually or as part of a group. Our loss of or inability to hire key employees could impair our ability to manage our business and direct its growth.

Our expansion into foreign countries exposes us to unfamiliar regulations and may expose us to new obstacles to growth.

We plan to grow both in the United States and in foreign countries. We have established operations in Argentina, Canada, Mexico, Ireland and the United Kingdom. Foreign operations carry special risks. Although

Table of Contents

our business in foreign countries has not yet been affected, our business in the countries in which we currently operate and those in which we may operate in the future could be limited or disrupted by:

- government controls;
- import and export license requirements;
- political or economic instability;
- trade restrictions;
- changes in tariffs and taxes;
- exchange rate fluctuations;
- our unfamiliarity with local laws, regulations, practices and customs;
- restrictions on repatriating foreign profits back to the United States;
- difficulties in staffing and managing international operations.

Foreign governments and agencies often establish permit and regulatory standards different from those in the United States. If we cannot obtain foreign regulatory approvals, or if we cannot obtain them when we expect, our growth and profitability from international operations could be limited. Fluctuations in currency exchange could have similar effects.

Our earnings could decline if we write-off intangible assets, such as goodwill.

As a result of purchase accounting for our various acquisitions, our balance sheet at December 31, 2006 contains goodwill of $814.0 million and other intangible assets, net of accumulated amortization, of $115.91 million (including indefinite lived intangibles of $32.2 million). In accordance with Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS No. 142), we evaluate on an ongoing basis, using the fair value of reporting units, whether facts and circumstances indicate any impairment of the value of indefinite-lived intangible assets such as goodwill. As circumstances after an acquisition can change, we may not realize the value of these intangible assets. If we were to determine that a significant impairment has occurred, we would be required to incur non-cash write-offs of the impaired portion of goodwill and other unamortized intangible assets, which could have a material adverse effect on our results of operations in the period in which the write-off occurs.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We lease office space for our corporate offices in Lake Forest, Illinois. In North America we own or lease three ETD treatment facilities, 11 incineration processing facilities, 34 autoclave processing facilities and five other processing facilities. All of our processing facilities also serve as collection sites. We own or lease 100 additional transfer and collection sites and nine additional sales/administrative sites. In Europe we own or lease 13 incineration processing facilities and 9 autoclave processing facilities. We also lease four additional transfer and collection sites and three administrative sites. In Argentina we own one processing facility, which uses a combination of both incineration and autoclave treatments. We consider that these processing facilities are adequate for our present and anticipated needs.

We do not own or operate any landfills or any other type of disposal site. After processing, all remaining waste materials are transported to unaffiliated third parties for permanent disposal.

Item 3. Legal Proceedings

We operate in a highly regulated industry and must deal with regulatory inquiries or investigations from time to time that may be instituted for a variety of reasons. We are also involved in a variety of civil litigation from time to time.

In June 2006, the United Kingdom Office of Fair Trading (OFT) referred to the United Kingdom Competition Commission (the Competition Commission) the acquisition by our subsidiary, Stericycle International, LLC, in February 2006 of all of the stock of The Sterile Technologies Group Limited (STG), an Irish company providing regulated waste management services in Ireland and the United Kingdom. Under the terms of the OFT s referral, the Competition Commission was to decide whether, as a result of the STG acquisition, there has been or is expected to be a substantial lessening of competition in one or more markets in the United Kingdom for healthcare risk waste services, and if so, what remedial or other actions, if any, should be taken or recommended by the Competition Commission.

On October 19, 2006, the Competition Commission issued provisional findings that the STG acquisition has resulted, or may be expected to result, in a substantial lessening of competition in the market for healthcare risk waste services requiring incineration in five geographical areas. The Competition Commission also issued a notice of possible remedies, including (i) a complete divestiture of STG s operations in England and Wales, (ii) a complete divestiture of STG s incinerators in England and Wales or (iii) a divestiture of STG s incinerators serving customers in the affected geographical areas.

On December 12, 2006, the Competition Commission published its final report on the STG acquisition. The Competition Commission confirmed its provisional findings and concluded that the STG acquisition has resulted, and may be expected to continue to result, in a substantial lessening of competition in the market for healthcare risk waste services requiring incineration in five geographical areas of England and Wales: northern England, the north Midlands, north Wales, the West Midlands and southeast Wales.

The Competition Commission accepted as a remedy our proposal to be allowed an initial period in which to sell three STG incinerators serving the affected geographical areas together with the associated customer contracts, subject to the Competition Commission s approval of the terms of sale and suitability of the purchaser. We completed the sale of the three incinerators in February 2007, within the period allowed by the Competition Commission.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of our stockholders during the fourth quarter of 2006.

Supplemental Information

Executive Officers of the Registrant

The following table contains certain information regarding our five current executive officers:

Name	Position	Age
Mark C. Miller	President, Chief Executive Officer and a Director	51
Richard T. Kogler	Executive Vice President and Chief Operating Officer	47
Frank J.M. ten Brink	Executive Vice President and Chief Financial Officer	50
Richard L. Foss	Executive Vice President, Corporate Development	52
Shan S. Sacranie	Executive Vice President, International	54
Michael J. Collins	President, Stericycle Return Management Services	50

Mark C. Miller has served as our President and Chief Executive Officer and a director since joining us in May 1992. From May 1989 until he joined us, Mr. Miller served as vice president for the Pacific, Asia and Africa in the International Division of Abbott Laboratories, which he joined in 1976 and where he held a number of management and marketing positions. He is a director of Ventana Medical Systems, Inc. Mr. Miller received a B.S. degree in computer science from Purdue University, where he graduated Phi Beta Kappa.

Richard T. Kogler joined us as Chief Operating Officer in December 1998. From May 1995 through October 1998, Mr. Kogler was vice president and chief operating officer of American Disposal Services, Inc., a solid waste management company. From October 1984 through May 1995, Mr. Kogler served in a variety of management positions with Waste Management, Inc. Mr. Kogler received a B.A. degree in chemistry from St. Louis University.

Frank J.M. ten Brink has served as our Executive Vice President, Finance and Chief Financial Officer since June 1997. From 1991 until 1996 he served as chief financial officer of Hexacomb Corporation, and from 1996 until joining us, he served as chief financial officer of Telular Corporation. Prior to 1991, he held various financial management positions with Interlake Corporation and Continental Bank of Illinois. Mr. ten Brink received a B.B.A. degree in international business and a M.B.A. degree in finance from the University of Oregon.

Richard L. Foss has served as our Executive Vice President for Corporate Development since February 2003. From 1999 to 2002, Mr. Foss was a vice president and director of worldwide product marketing in the personal communication sector at Motorola Inc., and from 1977 until 1999, he held a number of management and marketing positions at The Procter & Gamble Company, including serving as a vice president and general manager in the health care segment. Mr. Foss received a B.S. degree in chemistry and an M.B.A degree from Rensselear Polytechnic Institute.

Shan S. Sacranie joined us in May 2003 and became our Executive Vice President, International in November 2003. From 2001 to 2002 he was chief executive for Appliance Controls Group, Inc. and from 1995 to 2001, he was president of Oak Industries Inc. From 1978 to 1995 he held a number of management positions for Honeywell. Mr. Sacranie holds a BA degree (Hons) in economics from the University of Bombay, an M.B.A. degree from Minnesota State University and a J.D. from the William Mitchell College of Law.

Michael J. Collins has served as President of our Return Management Services Division since June 2006. Prior to joining us, he served at Abbott Laboratories, a diversified health care company, which he joined in 1982 and where he held a number of management and marketing positions, most recently as vice president, medical products group health systems. Mr. Collins received a B.A. degree in business and education from the University of New Haven and a M.B.A. degree in business administration from National University

Table of Contents

PART II

Item 5. Market Price of and Dividends on the Registrant s Common Equity and Related Stockholder Matters

As of February 22, 2007, we had approximately 180 stockholders of record. The Company s stock trades on the NASDAQ National Market under the ticker symbol SRCL.

The following table provides the high and low sales prices of our Common Stock for each calendar quarter during our two most recent fiscal years:

Quarter	High	Low
First quarter 2005	51.60	44.20
Second quarter 2005	53.82	43.92
Third quarter 2005	59.47	50.58
Fourth quarter 2005	63.52	54.36
First quarter 2006	67.62	57.28
Second quarter 2006	69.00	61.30
Third quarter 2006	69.79	61.07
Fourth quarter 2006	75.62	65.03

We did not pay any cash dividends during 2006 and have never paid any dividends on our capital stock. We currently expect that we will retain future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

In May 2002 our Board of Directors authorized the Company to repurchase up to 3,000,000 shares of our common stock, in the open market or through privately negotiated transactions, at times and in amounts in the Company s discretion. In February 2005, at a time when we had purchased a cumulative total of 1,478,430 shares, the Board authorized the Company to purchase up to an additional 1,478,430 shares, thereby giving the Company the authority to purchase up to a total of 3,000,000 additional shares. In February 2007, at a time when we had purchased an additional 1,571,040 shares since the 2005 stock purchase authorization, the Board authorized the Company to purchase up to an additional 1,571,040 shares, thereby giving the Company the authority to purchase up to a total of 3,000,000 additional shares. The following table provides information about our purchases during the year ended December 31, 2006 of shares of our common stock.

Issuer Purchases of Equity Securities

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Units) that May Yet Be Purchased Under the Plans or Programs
January 1 - January 31, 2006	181,800	57.99	181,800	1,914,700
February 1 - February 28, 2006	11,300	58.01	11,300	1,903,400
March 1 - March 31, 2006	0	0	0	1,903,400
April 1 - April 30, 2006	0	0	0	1,903,400
May 1 - May 31, 2006	2,000	59.45	2,000	1,901,400
June 1 - June 30, 2006	60,600	62.71	60,600	1,840,800
July 1 - July 31, 2006	164,945	62.45	164,945	1,675,855

August 1 - August 31, 2006	0	0	0	1,675,855
September 1 - September 30, 2006	9,913	67.5	9,913	1,665,942
October 1 - October 31, 2006	54,406	67.75	54,406	1,611,536
November 1 - November 30, 2006	24,117	69.47	24,117	1,587,419
December 1 - December 31, 2006	158,459	71.38	158,459	1,428,960

17

Table of Contents

Equity Compensation Plans

The following table summarizes information as of December 31, 2006 relating to our equity compensation plans pursuant to which stock option grants, restricted stock awards or other rights to acquire shares of our common stock may be made or issued:

Equity Compensation Plan Information

Plan Category	Number of Securities To Be Issued Upon Exercise Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by our security holders(1)	1,947,331	$ 43.36	1,953,893
Equity compensation plans not approved by our security holders(2)	1,571,324	$ 40.14	191,894

(1) These plans consist of our 2005 Plan, 1997 Plan, 1995 Plan, Directors Plan and ESPP.
(2) The only plan in this category is our 2000 Plan.

In 2000, our Board of Directors approved the 2000 Nonstatutory Stock Option Plan (the 2000 Plan), which in total now provides for the granting of 3,500,000 shares of our common stock in the form of stock options to employees, (but not to officers or directors).

18

Table of Contents

Performance Graph

The following graph compares the cumulative total return (i.e., stock price appreciation plus dividends) on our common stock over the five-year period ending December 31, 2006 with the cumulative total return for the same period on the Nasdaq National Market Composite Index, the Russell 3000 Index and an index of a peer group of companies that we selected consisting of Allied Waste Industries, Inc., SRI/Surgical Express, Inc. (formerly Sterile Recoveries, Inc.), Steris Corporation and Waste Management, Inc. The graph assumes that $100 was invested on December 31, 2001 in our common stock and in the stock represented by each of the three indexes, and that all dividends were reinvested.

The stock price performance of our common stock reflected in the following graph is not necessarily indicative of future performance.

Table of Contents

Item 6. Selected Consolidated Financial Data

	2006(3)	2005	2004	2003	2002
	Year Ended December 31, (Dollars in thousands, except per share amounts)				
Statements of Income Data(1)					
Revenues	$ 789,637	$ 609,457	$ 516,228	$ 453,225	$ 401,519
Income from operations	201,762	166,532	145,655	126,397	100,832
Net income	105,270	67,154	78,178	65,781	45,724
Net income applicable to common stock	105,270	67,154	78,178	65,781	45,037
Diluted net income per share of common stock(2)	2.33	1.48	1.69	1.43	1.01
Depreciation and amortization	27,036	21,431	21,803	17,255	14,981
Other Data					
Cash provided by operating activities	$ 160,162	$ 94,327	$ 114,611	$ 123,887	$ 98,731
Cash used in investing activities	(201,425)	(156,001)	(105,093)	(57,635)	(49,470)
Cash provided by (used in) financing activities	52,547	59,500	(6,941)	(66,820)	(53,705)
Balance Sheet Data (at December 31)(1)					
Cash, cash equivalents and short-term investments	$ 16,040	$ 8,545	$ 7,949	$ 7,881	$ 8,887
Total assets	1,327,906	1,047,660	834,141	707,462	667,095
Long-term debt, net of current maturities	443,115	348,841	190,431	163,016	224,124
Convertible redeemable preferred stock				20,944	28,049
Shareholders equity	$ 625,081	$ 521,634	$ 495,372	$ 407,820	$ 326,729

(1) See Note 4 to the Consolidated Financial Statements for information concerning our acquisitions during the three years ended December 31, 2006.

(2) See Note 10 to the Consolidated Financial Statements for information concerning the computation of net income per common share. In 2006, net income includes costs (net of tax) related to stock compensation expense of $6.5 million, a fixed asset write-down of equipment of $0.2 million, write-down of an investment in securities of $0.6 million, acquisition-related costs of $2.1 million, partially offset by income recorded from insurance proceeds related to the 3CI settlement of $0.6 million that in total negatively impacted EPS by $0.19 per share. Of the total of $8.8 million of such items, $7.3 million were non-cash items. In 2005, net income includes costs (net of tax) related to the 3CI preliminary settlement of class action litigation of $23.4 million, South Africa note receivable write-down of $1.5 million, fixed asset impairments of $0.5 million, acquisition-related costs of $0.5 million, settlement of licensing litigation of $1.1 million, and items related to debt restructuring of $0.3 million which negatively impacted EPS by $0.60 per share. Of the total of $27.3 million of such items, $3.4 million were non-cash items. In 2004, net income includes acquisition-related costs of $0.5 million, fixed asset write-offs of $0.7 million, and items related to debt restructuring and redemption of senior subordinated debt of $2.8 million that negatively impacted EPS by $0.09 per share. Of the total of $4.0 million of such items, $1.4 million were non-cash items. In 2003, net income includes acquisition-related costs (net of tax) of $0.4 million and items related to debt restructuring and subordinated debt repurchase of $2.0 million, which negatively impacted EPS by $0.04 per share. Of the total of $2.4 million of such items, $0.5 million were non-cash items. In 2002, net income includes acquisition-related costs (net of tax) of $0.2 million, fixed asset write-offs of $1.8 million and items related to debt restructuring and subordinated debt repurchases of $1.4 million, which negatively impacted EPS by $0.08 per share. Of the total of $3.4 million of such items, $2.0 million were non-cash items.

(3) On January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment (SFAS No. 123R) using the modified prospective method to account for stock compensation costs. SFAS No. 123R requires the measurement and recognition of compensation expense for all stock-based payment awards made to our employees and directors. During the year ended December 31, 2006, we recognized stock compensation expense of $6.5 million, net of tax. See Note 11 to the Consolidated Financial Statements for additional information related to stock compensation expense.

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes in Item 8 of this Report.

Introduction

We are in the business of managing regulated waste and providing an array of related services. We operate in the United States, the United Kingdom, Mexico, Canada, Ireland, and Argentina.

For large-quantity generators of regulated waste such as hospitals and for pharmaceutical companies and distributors, we offer: our institutional medical waste management services; our *Bio Systems*® sharps management services to reduce the risk of needle sticks; a variety of products and services for infection control; and our regulated returns management services for expired or recalled health care products.

For small-quantity generators of regulated waste such as doctors offices and for retail pharmacies, we offer: our medical waste management services; our *Steri-Safe*® Occupational Safety and Health Act and Health Insurance Portability and Accountability Act (HIPAA) compliance programs; a variety of products and services for infection control; and our pharmaceutical returns services for expired or recalled pharmaceuticals.

We operate integrated national medical waste management networks in the United States, Canada, Mexico, Argentina, the United Kingdom and Ireland. Our national networks include a total of 76 processing or combined processing and collection sites and 104 additional transfer, collection or combined transfer and collection sites.

Our medical waste processing technologies include autoclaving, our proprietary electro-thermal-deactivation system (ETD), chemical treatment and incineration.

As of December 31, 2006, we served approximately 351,700 customers, of which approximately 343,100 were small quantity customers and approximately 8,600 were large quantity customers.

Critical Accounting Policies and Procedures

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. We believe that of our significant accounting policies (see Note 2 to our consolidated financial statements), the following ones may involve a higher degree of judgment on our part and greater complexity of reporting.

Revenue Recognition. We recognize revenue for our regulated waste services at the time of waste collection. Revenues from regulated returns management services are recorded at the time services are performed. Royalty revenues are calculated based on measurements specified in each contract or license and revenues are recognized at the end of each reporting period when the activity being measured has been completed. Revenues from product sales are recognized at the time the goods are shipped to the ordering customer. Software licensing revenues are recognized on a prorated basis over the term of the license agreement. Revenue and costs on contracts to supply our proprietary ETD treatment equipment are recognized based on shipment of equipment and services provided for in the individual contract. We had no revenues related to ETD sales in 2006 or 2005. We do not have any contracts in a loss position. Losses would be recorded when known and estimable for any contracts that should go into a loss position. Payments received in advance are deferred and recognized as services are provided.

Goodwill and Other Identifiable Intangible Assets. Goodwill associated with the excess purchase price over the fair value of assets acquired is not amortized. We have determined that our permits have indefinite lives and, accordingly are not amortized. This position is in accordance with Statement of Financial Accounting

Table of Contents

Standards (SFAS) No. 142, which became effective for fiscal years beginning after December 15, 2001. See Note 8 Goodwill and Other Intangible Assets for additional information.

Our balance sheet at December 31, 2006 contains goodwill of $814.0 million. In accordance with SFAS No. 142, we evaluate on at least an annual basis, using the fair value of reporting units, whether goodwill is impaired. If we were to determine that a significant impairment has occurred, we would be required to incur non-cash write-offs of the impaired portion of goodwill that could have a material adverse effect on our results of operations in the period in which the write-off occurs. We use the market value of our stock as a measure of fair value and compare that to the ratio of earnings before income tax expense, depreciation expense, and amortization expense, to book value of each of our reporting unit when testing for goodwill impairment, and any unforeseen material drop in our stock price may be an indicator of a potential impairment of goodwill. The results of the 2006 impairment test conducted in June 2006 did not show any impairment of goodwill, and no events have occurred since that time that indicate that an impairment situation exists.

Our permits are currently tested for impairment annually at December 31, or more frequently if circumstances indicate that they may be impaired. We use a discounted cash flow model as the current measurement of the fair value of the permits. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by management. Our estimates of discounted cash flow may differ from actual cash flow due to, among other things, inaccuracies in economic estimates, and actual cash flow could materially affect the future financial value of the permits. The results of the 2006 impairment test did not show any impairment of our permits and no events have occurred since that time that would indicate an impairment situation exists.

Other identifiable intangible assets, such as customer lists, tradenames and covenants not-to-compete, are currently amortized using the straight-line method over their estimated useful lives. We have determined that our regulated waste customer lists have between 20-year and 40-year lives based on the specific type of relationship. These assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may be less than the undiscounted cash flows. There have been no indicators of impairment of these intangibles (see Note 8 to our consolidated financial statements).

Income Taxes. Deferred income tax liabilities and assets are determined based on the differences between the financial statement and income tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. To provide for certain potential tax exposures, we maintain a reserve for specific tax contingencies, the balance of which management believes is adequate.

Accounts Receivable. Accounts receivable consist primarily of amounts due to us from our normal business activities. Accounts receivable balances are determined to be delinquent when the amount is past due based on the contractual terms with the customer. We maintain an allowance for doubtful accounts to reflect the expected uncollectibility of accounts receivable based on past collection history and specific risks identified among uncollected accounts. Accounts receivable are charged to the allowance for doubtful accounts when we have determined that the receivable will not be collected and/or when the account has been referred to a third party collection agency. No single customer accounts for more than 2% of our revenues.

Insurance. Our insurance for worker s compensation, vehicle liability and physical damage, and employee-related health care benefits is obtained using high deductible insurance polices. A third-party administrator is used to process all such claims. We require all workers compensation, vehicle liability and physical damage claims to be reported within 24 hours. As a result, we accrue our worker s compensation, vehicle and physical damage liability based upon the claim reserves established by the third-party administrator at the end of each reporting period. Our employee health insurance benefit liability is based on our historical claims experience rate. Our earnings would be impacted to the extent that actual claims vary from historical experience. We review our accruals associated with the exposure to these liabilities for adequacy at the end of each reporting period.

Litigation. We operate in a highly regulated industry and deal with regulatory inquiries or investigations from time to time that may be instituted for a variety of reasons. We are also involved in a variety of civil litigation from time to time. Settlements from litigation would be recorded when known, probable and estimable.

Table of Contents

Stock Option Plans. We have issued stock options to employees and directors as an integral part of our compensation programs. On January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment (SFAS No. 123R) using the modified prospective method to account for stock compensation costs. SFAS No. 123R requires the measurement and recognition of compensation expense for all stock-based payment awards made to our employees and directors. Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires considerable judgment, including estimating expected volatility, expected term and risk-free rate. Our expected volatility is based upon historical experience. The expected term of the stock options is based upon historical experience. The risk-free interest rate assumption is based upon the average of the U.S. Treasury three and five-year yield rates. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

The following summarizes (in thousands except per share amounts) our operations:

	Year Ended December 31,			
	2006		2005	
Revenues	$ 789,637	100.0%	$ 609,457	100.0%
Cost of revenues	419,689	53.1%	324,988	53.3%
Depreciation	20,081	2.5%	16,432	2.7%
Total cost of revenues	439,770	55.7%	341,420	56.0%
Gross profit	349,867	44.3%	268,037	44.0%
Selling, general and administrative	137,411	17.4%	93,033	15.3%
Depreciation	3,989	0.5%	3,403	0.6%
Amortization	2,966	0.4%	1,596	0.3%
Total selling, general and administrative expenses	144,366	18.3%	98,032	16.1%
Licensing legal settlement			1,823	0.3%
Write off fixed assets	300	0.0%	872	0.1%
Acquisition integration related expenses	3,439	0.4%	778	0.1%
Income from operations	201,762	25.6%	166,532	27.3%
Write-down of investment in securities	1,000	0.2%		
Write-down of note receivable with former joint venture			2,495	0.4%
3CI legal settlement(2005)/proceeds from insurance(2006)	(1,025)	-0.1%	36,481	6.0%
Net interest expense	27,061	3.4%	12,247	2.0%
Income tax expense	67,304	8.5%	44,826	7.4%
Net income	$ 105,270	13.3%	$ 67,154	11.0%
Earnings per share diluted	$ 2.33		$ 1.48	

Revenues. Our revenues increased $180.2 million, or 29.6%, to $789.6 million in 2006 from $609.5 million in 2005. Revenues primarily increased as a result of domestic and international acquisitions. During 2006, acquisitions less than one year old contributed approximately $116.1 million to the increase in our revenues from 2005. In addition, strong revenue growth was exhibited in our Steri-Safe^{SM} product offerings as a result of increased market penetration in the small quantity generator markets, continued success in the rollout of our *Bio Systems* sharps management program and growth in returns management services revenues. For the year, internal growth for small account customers increased approximately 11% while revenues from large quantity customers increased by approximately 9%.

Table of Contents

During 2006, the size of the regulated waste market in the United States for the services we provide remained relatively stable. Through our acquisition of STG and Habitat Ecologico S.A. in February 2006, we were able to expand our geographic presence outside of North America.

Cost of Revenues. Our cost of revenues increased $98.4 million or 28.8%, to $439.8 million during 2006, from $341.4 million during 2005. This was primarily due to an increase in incremental expenses as a result of business acquisitions completed during 2006 and 2005. Our gross margin percentage increased to 44.3% during 2006 from 44.0% during 2005 due to an increase in gross margins on our domestic business as we continued to realize efficiencies from ongoing programs to improve the gross margins on our large and small quantity business. Domestic energy and transportation costs increased in 2006, which were partially offset by higher revenues related to fuel surcharges.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses, less stock compensation expense, increased $36.6 million or 37.2% to $144.4 million during 2006 from $98.0 million during 2005. This increase was primarily the result of incremental overhead expenses as a result of our acquisition of STG in 2006 and other acquisitions completed in the fourth quarter in 2005. Effective January 1, 2006 we adopted Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payments (SFAS No. 123R) using the modified prospective basis, which resulted in a change in the way we recognize share-based compensation expense, which increased selling, general and administrative expenses by $9.8 million or 1.0% as a percentage of revenue. Bad debt expense increased during 2006 to $4.2 million from $2.7 million in 2005 due to higher sales. Amortization expense increased to $3.0 million during 2006, from $1.6 million during 2005 as a result of amortization of new intangibles during 2006 and 2005. Selling, general and administrative expenses as a percentage of revenue increased to 18.3% during 2006 compared to 16.1% in 2005 as a result of the factors described above.

Income from Operations. Income from operations increased $35.2 million or 21.2% to $201.8 million during 2006 from $166.5 million during 2005. The increase was due to higher gross margin partially offset by higher selling, general and administrative expenses. During the year ended December 31, 2006, we recorded expenses of $3.4 million related to acquisition integration compared to $0.8 million in 2005. Of the $3.4 million of 2006 expense, approximately $1.1 million related to facility closures; one in the United States and one in the United Kingdom. During the year ended December 31, 2006 we recorded a $0.3 million non-cash write-down of equipment acquired from 3CI. During the year ended December 31, 2005 we recorded a non-cash impairment charge of $0.9 million related to our Springhill, Louisiana building and property. Income from operations as a percentage of revenue decreased to 25.6% during 2006 from 27.3% during 2005 as a result of the factors described above.

Interest Expense and Interest Income. Interest expense increased to $28.4 million during 2006, from $13.0 million during 2005, primarily due to higher debt levels and higher interest rates during the year. Interest income was $1.4 million during 2006 and $0.8 million during 2005.

Write-down of investment. During 2006 we had a $1.0 million non-cash write-down of an investment in securities.

Proceeds from Insurance. During 2006 we received $1.0 million for insurance proceeds related to the 3CI litigation.

Income Tax Expense. Income tax expense for the years 2006 and 2005 reflects an effective tax rate of approximately 39.0% and 40.0%, respectively, for federal and state income taxes. The legal settlement negatively impacted our 2005 effective tax rate by 1.0%

Table of Contents

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

The following summarizes (in thousands except per share amounts) our operations:

	Year Ended December 31,			
	2005		2004	
Revenues	$ 609,457	100.0%	$ 516,228	100.0%
Cost of revenues	324,988	53.3%	271,189	52.5%
Depreciation	16,432	2.7%	16,833	3.3%
Total cost of revenues	341,420	56.0%	288,022	55.8%
Gross profit	268,037	44.0%	228,206	44.2%
Selling, general and administrative	93,033	15.3%	75,653	14.7%
Depreciation	3,403	0.6%	2,540	0.5%
Amortization	1,596	0.3%	2,430	0.5%
Total selling, general and administrative expenses	98,032	16.1%	80,623	15.6%
Licensing legal settlement	1,823	0.3%		
Write off fixed assets	872	0.1%	1,155	0.2%
Acquisition integration related expenses	778	0.1%	773	0.1%
Income from operations	166,532	27.3%	145,655	28.2%
Write-down of note receivable with former joint venture	2,495	0.4%		
3CI legal settlement	36,481	6.0%		
Net interest expense	12,247	2.0%	10,628	2.1%
Income tax expense	44,826	7.4%	50,386	9.8%
Net income	$ 67,154	11.0%	$ 78,178	15.1%
Earnings per share diluted	$ 1.48		$ 1.69	

Revenues. Our revenues increased $93.2 million, or 18.1%, to $609.5 million in 2005 from $516.2 million in 2004. Revenues generated from the sale of ETD equipment and licensing of technology internationally were $1.0 million during 2005, compared to $8.2 million during 2004. This decrease is a result of the delivery of a large portion of an order of ETD equipment to a customer in Japan in 2004. During 2005, acquisitions less than one year old contributed approximately $63.6 million to the increase in our revenues from 2004. For the year, internal growth for small account customers increased approximately 9% while revenues from large quantity customers increased by approximately 5%.

During 2005, the size of the regulated waste market in the United States for the services we provide remained relatively stable. Through our acquisition of White Rose Environmental Ltd. in June 2004 and subsequent United Kingdom acquisitions in 2005, we were able to expand our geographic presence outside of North America.

Cost of Revenues. Our cost of revenues increased $53.4 million or 18.5%, to $341.4 million during 2005, from $288.0 million during 2004. The increase was primarily related to the increase in revenues during 2005 compared to 2004. Our gross margin percentage decreased to 44.0% during 2005 from 44.2% during 2004 as we experienced higher energy related costs. Domestic energy costs increased in 2005, which were partially offset by higher revenues related to fuel surcharges. Employee benefit costs as a percentage of compensation costs decreased by 2.0 % in 2005. This was a result of the changes to our employee healthcare programs including changes to our providers and program formats.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased to $98.0 million during 2005, from $80.6 million during 2004. This increase was primarily the result of increased spending on marketing our Steri-Safe^{SM} program and *Bio Systems* sharps management program and the expansion into the pharmaceutical services programs. Bad debt expense increased during 2005 to $2.7 million

from $0.8 million in 2004 due to higher sales and increased write-offs in 2005. In addition, as noted in the cost of revenues discussion above, employee benefit costs as a percentage of compensation costs decreased in 2005. Amortization decreased to $1.6 million during 2005, from $2.4 million during 2004 as a result of some intangibles becoming fully amortized at the end of 2004. Selling, general and administrative expenses as a percentage of revenue increased to 16.2% during 2005 compared to 15.8% in 2004 as a result of the factors described above.

Income from Operations. Income from operations increased to $166.5 million during 2005 from $145.7 million during 2004. The increase was due to higher revenues partially offset by higher costs of revenues and selling, general and administrative expenses. During the year ended December 31, 2005, 3CI Complete Compliance Corporation, of which we own a majority of the common stock, recorded a non-cash impairment charge of $0.9 million on its Springhill, Louisiana building and property. In December 2005, we recorded a cash charge of $0.4 million for damages and a non-cash charge of $1.4 million, representing the write-off of the unamortized portion of a license fee that we previously paid, as a result of an arbitrator s award in March 2006 and the license agreement being effectively terminated. During the year ended December 31, 2004 we recorded a non-cash write-down of idled Stericycle incinerator equipment at our Baltimore, Maryland and Terrell, Texas facility of $1.2 million. Income from operations as a percentage of revenue decreased to 27.3% during 2005 from 28.2% during 2004 as a result of the factors described above.

Interest Expense and Interest Income. Interest expense increased to $13.0 million during 2005, from $11.2 million during 2004, primarily due to higher debt levels during the year. Interest income was $0.8 million during 2005 and $0.6 million during 2004.

Write-down of note receivable. During 2005 we wrote-down a $2.5 million note receivable that we had recorded from the sale of interest in our former South African joint venture when we had determined that the amount was uncollectible.

Legal Settlements. During November 2005 we incurred $36.5 million in expenses related to the preliminary settlement of the 3CI class action litigation and related legal expenses.

Debt Extinguishments and Refinancing Expenses. During 2005 we incurred $0.5 million in refinancing expense for non-cash accelerated amortization of financing fees related to amendments to our bank credit facility agreements. During 2004 we repurchased the remaining $50.9 million of our senior subordinated notes. As a result, in 2004 we incurred $3.1 million in redemption premium expenses and $1.1 million in non-cash accelerated amortization of financing fees associated with the repurchase of the notes.

Income Tax Expense. Income tax expense for the years 2005 and 2004 reflects an effective tax rate of approximately 40.0% and 39.2%, respectively, for federal and state income taxes. The legal settlement negatively impacted our 2005 effective tax rate by 1.0%

Liquidity and Capital Resources

On July 31, 2006, we, and certain of our subsidiaries entered into a new credit agreement (Credit Agreement) with Bank of America, N.A., and other lenders party to the Credit Agreement. The new credit agreement is in effect an amendment of our prior senior unsecured credit facility.

The new credit agreement (i) reduces our costs of borrowing by using a more favorable pricing grid; (ii) increases our revolving credit facility from $550 million to $650 million; (iii) increases the accordion (the amount for which we may request an increase in the size of our revolving credit facility) from $100 million to $200 million; (iv) increases the letter of credit sublimit from $150 million to $200 million; (v) increases the foreign currency sublimit from $125 million to $200 million; (vi) increases the debt-to-EBITDA covenant from 3.00:1.00 to 3.75:1.00; and (vii) extends the maturity date of our borrowings from June 30, 2010 to July 31, 2011.

Table of Contents

The new credit agreement reduces our costs of borrowing by reducing the applicable margin that is added to the relevant interest rate that we are charged. Our borrowings bear interest at fluctuating interest rates determined, at our election in advance for any quarterly or other applicable interest period, by reference to (i) a base rate (the higher of the prime rate at Bank of America, N.A. or 0.5% above the rate on overnight federal funds transactions) or (ii) the London Interbank Offered Rate, or LIBOR, plus, in either case, the applicable margin within the relevant range of margins provided in our credit agreement. Under the new credit agreement, the applicable margin is based on (i) our consolidated leverage ratio, or, if our long-term non-credit enhanced debt has been rated by Standard & Poors, (ii) our S&P debt rating, whichever margin is more favorable to us. As of December 31, 2006, the margin for interest rates on borrowings under our new credit facility was 0.0% on base rate loans and 0.75% on LIBOR loans.

The new credit agreement contains customary events of default, including our failure to pay any principal, interest or other amount when due, our violation of certain of our affirmative covenants or any of our negative covenants, a breach of our representations and warranties, or a change of control. Upon the occurrence of an event of default, payment of our indebtedness may be accelerated and the lending commitments under the credit agreement may be terminated.

As of December 31, 2006, we had $387.3 million of borrowings outstanding under our senior unsecured credit facility, which includes foreign currency borrowings of $9.3 million. In addition, we had $48.8 million committed to outstanding letters of credit. The weighted average rate of interest on the unsecured revolving credit facility was 6.08% for the year ended December 31, 2006. At December 31, 2006, we had $77.9 million in other debt outstanding, which includes promissory notes issued in connection with acquisitions during 2003 through 2006 and foreign subsidiary bank debt.

Working Capital. At December 31, 2006, our working capital was $76.6 million compared to working capital of $45.3 million at December 31, 2005. Of the change in working capital, $26.5 million is related to Asset group held for sale as this amount is primarily comprised of fixed assets and intangible assets that will be sold, presented as current assets, per accounting rules. As noted, we have available a $650.0 million revolving line of credit under our senior unsecured credit facility and at December 31, 2006 had borrowed $387.3 million under this line and had an additional $48.8 million committed in letters of credit.

Net Cash Provided or Used. Net cash provided by operating activities was $160.2 million during the year ended December 31, 2006 compared to $94.3 million for 2005. This increase primarily reflects higher net income and an emphasis on improved collections. 2005 net income included a $23.4 million, net of tax, settlement of the 3CI class action litigation. As a result of adopting SFAS No. 123R effective January 1, 2006, benefits of tax deductions in excess of recognized compensation expense is reported as a financing cash flow, rather than as an operating cash flow as prescribed under the prior accounting rules. This requirement reduces net operating cash flow and increases net financing cash flows in periods after adoption. Total cash flows remain unchanged from what would have been reported under prior accounting rules. As a result $8.4 million in tax benefits on stock options exercised was reported as cash provided from financing activities for the year ended December 31, 2006 compared to $7.4 million reported as cash provided by operating activities for the year ended December 31, 2005.

Net cash used in investing activities for 2006 was $201.4 million compared to $156.0 million for 2005. This increase is primarily attributable to the increase in payments for acquisitions. Cash investments in acquisitions and international joint ventures for 2006 were $164.0 million compared to $139.7 million in 2005. The increase was primarily the result of our acquisition of STG. Capital expenditures were $36.4 million for 2006, for investments in capital equipment to support the growth of the *Bio Systems* sharps management program and other improvements in our infrastructure, compared to $26.3 million in 2005. As of December 31, 2006 we had less than 8% of our treatment capacity in North America in incineration and approximately 92% in non-incineration technologies such as our proprietary ETD technology and autoclaving. The implementation of our commitment to move away from incineration in North America may result in a write-down of the incineration equipment as and when we close incinerators that we are currently operating. Our commitment to move away from incineration in North America is in the nature of a goal to be accomplished over an undetermined number of years. Because

Table of Contents

of uncertainties relating, among other things, to customer education and acceptance and legal requirements to incinerate portions of the regulated waste, we do not have a timetable for this transition or specific plans to close any of our existing incinerators.

Net cash provided by financing activities was $52.5 million during 2006 compared to $59.5 million in 2005. During 2006 we borrowed money to fund acquisitions and common stock repurchases. During 2006, we made $42.8 million in common stock repurchases, $30.7 million in promissory notes payments $266.0 million in debt repayments and $0.8 million for capital leases. In 2005, we borrowed money to fund acquisitions, stock repurchases and the 3CI legal settlement while we made debt repayments of $198.9 million when we terminated our 2001 senior credit facility, $12.8 million repayments on promissory notes and $0.8 million for capital leases.

Contractual Cash Commitments. The following table displays our future contractual cash commitments.

Payments due by period (in thousands)	**Total**	**Less than 1 year**	**1-3 years**	**4 - 5 years**	**After 5 years**
Long term debt*	$ 558,407	$ 49,536	$ 101,159	$ 407,623	$ 89
Capital lease obligations*	689	447	214	28	
Purchase obligations	1,307	470	837		
Operating leases	135,946	31,196	66,298	35,273	3,179
Other long-term liabilities*	2,515	838	1,248	264	165
Total contractual cash obligations	$ 698,864	$ 82,487	$ 169,756	$ 443,188	$ 3,433

* The long-term debt, capital lease and other long-term liabilities items include both the future principal payment amount as well as an amount calculated for expected future interest payments. For long-term debt with variable rates of interest, management used judgment to estimate the future rate of interest. Other long-term liabilities include amounts related to non-compete agreements.

At December 31, 2006 we had $48.8 million in stand-by letters of credit issued.

We anticipate that our operating cash flow, together with borrowings under our senior secured credit facility, will be sufficient to meet our anticipated future operating expenses, capital expenditures and debt service obligations as they become due during the next 12 months and the foreseeable future.

Guarantees: We have guaranteed a loan to the Aozora Bank in Japan on behalf of Shiraishi-Sogyo Co. Ltd (Shiraishi). Shiraishi is a customer in Japan that is expanding their regulated waste management business and has a five-year loan with a current balance of $4.8 million with the Aozora Bank that expires in June 2009. Management currently believes no amount will be paid under the guarantee.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are subject to market risks arising from changes in interest rates on our senior unsecured credit facility. Our interest rate exposure results from changes in LIBOR or the base rate, which are used to determine the applicable interest rates under our revolving credit facility. Our potential loss over one year that would result from a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate on all of our variable rate obligations would be approximately $4.2 million.

We have exposure to commodity pricing for gas and diesel fuel for our trucks. We do not hedge these items to manage the exposure. We have exposure to foreign exchange related to loans denominated in a foreign currency. We have two loans denominated in GBP for which we have a cash flow hedge. Foreign exchange could also negatively impact reported net income due to translation.

Table of Contents

Item 8. Consolidated Financial Statements and Supplemental Data

Management s Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, a company s principal executive and principal financial officers and effected by the company s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company s internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*.

The Company s audited consolidated financial statements include the results of its consolidated operations in Ireland and the United Kingdom related to Stericycle Ireland, Ltd. These operations began on March 1, 2006 when the Company acquired all of the stock of Sterile Technologies Group, a Republic of Ireland company, now doing business as Stericycle Ireland, Ltd. Management s assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the results of its consolidated operations in Ireland and the United Kingdom related to Stericycle Ireland, Ltd. These operations began on March 1, 2006 when the Company acquired all of the stock of Sterile Technologies Group, a Republic of Ireland company, now doing business as Stericycle Ireland, Ltd. Management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2006 did not include an assessment of the internal control over financial reporting of the Company s consolidated operations of Stericycle Ireland, Ltd. As of December 31, 2006, the total assets and net assets of Stericycle Ireland, Ltd including intangibles and assets held for sale, were $167.6 million and $134.7 million, respectively, and its revenues and net income for the ten months ended December 31, 2006 were $54.2 million and $9.9 million, respectively.

Based on this assessment and those criteria, management concludes that the Company maintained effective internal control over financial reporting as of December 31, 2006.

The Company s independent auditors have issued an attestation report on management s assessment of the Company s internal control over financial reporting. That report appears on page 30.

Stericycle, Inc.

Lake Forest, IL

February 28, 2007

Table of Contents

Report of Independent Registered Public Accounting Firm

on Internal Control over Financial Reporting

The Board of Directors and Shareholders of Stericycle, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Stericycle, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Stericycle, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management s Report on Internal Control Over Financial Reporting, management s assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the results of its consolidated operations in Ireland and the United Kingdom related to Stericycle Ireland, Ltd. These operations began on March 1, 2006 when the Company acquired all of the stock of Sterile Technologies Group, a Republic of Ireland company, now doing business as Stericycle Ireland, Ltd. As of December 31, 2006, the total assets and net assets of Stericycle Ireland, Ltd including intangibles and assets held for sale, were $167.6 million and $134.7 million, respectively, and its revenues and net income for the ten months ended December 31, 2006 were $54.2 million and $9.9 million, respectively. Our audit of internal control over financial reporting of Stericycle, Inc. also did not include an evaluation of the internal control over financial reporting of the Stericycle Ireland, Ltd subsidiary.

Table of Contents

In our opinion, management s assessment that Stericycle, Inc. maintained effective internal control over financial reporting as of December 31, 2006 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Stericycle, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Stericycle, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, cash flows and changes in shareholders equity for each of the three years in the period ended December 31, 2006 and our report dated February 28, 2007, expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois

February 28, 2007

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Stericycle, Inc.

We have audited the accompanying consolidated balance sheets of Stericycle, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, cash flows and changes in shareholders equity for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Stericycle, Inc. and Subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As disclosed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for stock-based compensation in accordance with the guidelines provided in Statement of Financial Accounting Standards No. 123(R) Share-Based Payment on January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Stericycle, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois

February 28, 2007

Table of Contents

STERICYCLE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share and per share data)

	December 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,492	$ 7,825
Short-term investments	2,548	720
Accounts receivable, less allowance for doubtful accounts of $5,411 in 2006 and $4,810 in 2005	130,354	103,703
Parts and supplies	6,366	5,263
Prepaid expenses	9,152	6,523
Notes receivable	2,773	3,164
Deferred income tax	16,072	13,452
Asset group held for sale	33,674	
Other	4,171	3,392
Total current assets	218,602	144,042
Property, plant and equipment:		
Land	10,582	8,190
Buildings and improvements	52,384	48,149
Machinery and equipment	173,769	144,795
Office equipment and furniture	27,342	21,581
Internally developed software	2,567	1,101
Construction in progress	11,116	11,220
	277,760	235,036
Less accumulated depreciation	(120,807)	(98,816)
Property, plant and equipment, net	156,953	136,220
Other assets:		
Goodwill	813,973	685,169
Intangible assets, less accumulated amortization of $11,454 in 2006 and $8,965 in 2005	115,879	61,641
Notes receivable	14,546	10,672
Other	7,953	9,916
Total other assets	952,351	767,398
Total assets	$ 1,327,906	$ 1,047,660
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long term debt	$ 22,681	$ 12,044
Accounts payable	25,033	27,872
Accrued liabilities	75,434	48,450
Deferred revenue	11,662	10,394
Liability group held for sale	7,221	
Total current liabilities	142,031	98,760

Long-term debt, net of current portion	443,115	348,841
Deferred income tax	105,521	71,549
Other liabilities	12,158	6,876
Common shareholders equity:		
Common stock (par value $.01 per share, 80,000,000 shares authorized, 44,251,965 issued and outstanding in 2006, 44,149,722 issued and outstanding in 2005)	443	442
Additional paid-in capital	252,568	259,075
Accumulated other comprehensive income	5,229	546
Retained earnings	366,841	261,571
Total shareholders equity	625,081	521,634
Total liabilities and shareholders equity	$ 1,327,906	$ 1,047,660

The accompanying notes are an integral part of these financial statements.

33

Table of Contents

STERICYCLE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except for share and per share data)

	Year Ended December 31, 2006	2005	2004
Revenues	$ 789,637	$ 609,457	$ 516,228
Costs and expenses:			
Cost of revenues	439,770	341,420	288,022
Selling, general and administrative expenses	144,366	98,032	80,623
Licensing legal settlement		1,823	
Write off of fixed assets	300	872	1,155
Acquisition integration related expenses	3,439	778	773
Total costs and expenses	587,875	442,925	370,573
Income from operations	201,762	166,532	145,655
Other income (expense):			
Interest income	1,358	764	558
Interest expense	(28,419)	(13,011)	(11,186)
Other expense, net	(2,152)	(2,882)	(1,889)
Write-down of investment in securities	(1,000)		
Debt extinguishments and refinancing		(447)	(4,574)
Write-down of note receivable with former joint venture		(2,495)	
3CI legal settlement(2005)/proceeds from insurance (2006)	1,025	(36,481)	
Total other expense	(29,188)	(54,552)	(17,091)
Income before income taxes	172,574	111,980	128,564
Income tax expense	67,304	44,826	50,386
Net income	$ 105,270	$ 67,154	$ 78,178
Earnings per share Basic	$ 2.39	$ 1.52	$ 1.77
Earnings per share Diluted	$ 2.33	$ 1.48	$ 1.69
Weighted average number of common shares outstanding Basic	44,075,036	44,284,580	44,250,913
Weighted average number of common shares outstanding Diluted	45,106,540	45,310,509	46,195,897

The accompanying notes are an integral part of these financial statements.

Table of Contents

STERICYCLE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2006	**2005**	**2004**
OPERATING ACTIVITIES:			
Net income	$ 105,270	$ 67,154	$ 78,178
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock compensation expense	10,610	27	21
Write-down of investment in securities	1,000		
Write-off of deferred financing costs		447	1,094
Write-down of note receivable with former joint venture		2,495	
Fees paid for extinguishment of senior subordinated debt			3,147
Write-off of licensing intangible		1,431	
Loss on sale and impairment of fixed assets	300	872	1,515
Excess tax benefit of disqualifying dispositions of stock options and exercise of non-qualified stock options	(8,427)	7,432	7,719
Depreciation	24,070	19,835	19,373
Amortization	2,966	1,596	2,430
Deferred income taxes	12,937	13,514	13,849
Change in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(14,742)	(19,679)	(4,986)
Parts and supplies	(744)	(962)	(494)
Prepaid expenses and other assets	4,538	(1,909)	6,301
Accounts payable	(6,003)	7,393	(5,123)
Accrued liabilities	28,107	(8,056)	(5,926)
Deferred revenue	280	2,737	(2,487)
Net cash provided by operating activities	160,162	94,327	114,611
INVESTING ACTIVITIES:			
Payments for acquisitions and international investments, net of cash acquired	(164,015)	(139,696)	(72,408)
Proceeds from maturity/(purchases) of short-term investments	(1,828)	(621)	542
Net proceeds from sale of assets from acquisition		10,328	
Proceeds from sale of property and equipment	832	302	85
Capital expenditures	(36,414)	(26,314)	(33,312)
Net cash used in investing activities	(201,425)	(156,001)	(105,093)
FINANCING ACTIVITIES:			
Proceeds from issuance of notes payable	5,953	735	12,435
Repayments of senior subordinated debt			(54,012)
Repayment of notes payable	(30,735)	(12,845)	(4,402)
Net borrowings from 2001 senior credit facility		27,500	61,695
Repayment of 2001 senior credit facility		(198,853)	
Borrowings on 2005 senior credit facility	362,452	371,522	
Repayments on 2005 senior credit facility	(265,988)	(79,853)	
Payments of deferred financing costs	(453)	(1,484)	
Principal payments on capital lease obligations	(816)	(795)	(996)
Purchase/cancellation of treasury stock	(42,757)	(60,657)	(34,847)
Proceeds from other issuances of common stock	16,464	14,230	13,186

Excess tax benefit of stock options exercised		8,427				
Net cash provided by (used in) financing activities		52,547		59,500		(6,941)
Effect of exchange rate changes on cash		(5,617)		2,149		(1,967)
Net increase (decrease) in cash and cash equivalents		5,667		(25)		610
Cash and cash equivalents at beginning of year		7,825		7,850		7,240
Cash and cash equivalents at end of year	$	13,492	$	7,825	$	7,850
Non-cash activities:						
Net issuances of notes payable for certain acquisitions	$	30,157	$	49,736	$	17,795
Net issuances of common stock and warrants for certain acquisitions	$	750	$		$	441

The accompanying notes are an integral part of these financial statements.

35

Table of Contents

STERICYCLE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

Years Ended December 31, 2006, 2005 and 2004

(in thousands)

	Issued and Outstanding Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balances at December 31, 2003	41,868	$ 420	$ 290,631	$ 116,239	$ 530	$ 407,820
Issuance of common stock for exercise of options and warrants and employee stock purchases	808	8	13,178			13,186
Conversion of Preferred Stock	2,836	28	20,916			20,944
Purchase/Cancellation of treasury stock	(789)	(8)	(34,839)			(34,847)
Common stock and warrants issued for acquisitions	9		441			441
Excess tax benefit of disqualifying dispositions of stock options and exercise of non-qualified stock options			7,719			7,719
Currency translation adjustment					1,934	1,934
Change in fair value of cashflow hedge					(3)	(3)
Net income				78,178		78,178
Comprehensive income						80,109
Balances at December 31, 2004	44,732	$ 448	$ 298,046	$ 194,417	$ 2,461	$ 495,372
Issuance of common stock for exercise of options and warrants and employee stock purchases	668	7	14,241			14,248
Purchase/Cancellation of treasury stock	(1,250)	(13)	(60,644)			(60,657)
Excess tax benefit of disqualifying dispositions of stock options and exercise of non-qualified stock options			7,432			7,432
Currency translation adjustment					(1,817)	(1,817)
Change in fair value of cashflow hedge					(98)	(98)
Net income				67,154		67,154
Comprehensive income						65,239
Balances at December 31, 2005	44,150	$ 442	$ 259,075	$ 261,571	$ 546	$ 521,634
Issuance of common stock for exercise of options and warrants and employee stock purchases	770	8	17,206			17,214
Purchase/Cancellation of treasury stock	(668)	(7)	(42,750)			(42,757)
Stock compensation expense			10,610			10,610
Excess tax benefit of disqualifying dispositions of stock options and exercise of non-qualified stock options			8,427			8,427
Currency translation adjustment					4,350	4,350
Change in fair value of cashflow hedge					333	333

Net income						105,270					105,270
Comprehensive income											109,953
Balances at December 31, 2006	44,252	$	443	$	252,568	$ 366,841	$		5,229	$	625,081

The accompanying notes are an integral part of these financial statements

Table of Contents

STERICYCLE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Unless the context requires otherwise, we, us or our refers to Stericycle, Inc. and its subsidiaries on a consolidated basis.

Note 1 Description of Business

We were incorporated in 1989 and presently serve approximately 351,700 customers throughout the United States, United Kingdom, Mexico, Canada, Ireland, Argentina, and Puerto Rico. In North America we have a fully integrated, national network. Our network includes 53 processing centers and 100 additional transfer and collection sites. We use this network to provide a broad range of services to our customers including regulated medical waste management services and regulated return management services. Regulated medical waste management services include servicing a variety of customers to remove and process waste while regulated return management services are physical services provided to companies and individual businesses that assist with the handling of products that are being removed from the supply chain due to recalls and expiration. These services also included advanced notification technology that is used to communicate specific instructions to the users of the product. Our waste treatment technologies include autoclaving, incineration, chemical treatment and our proprietary electro-thermal-deactivation system. In the United Kingdom we have a fully integrated network, which includes 22 processing/collection centers and four additional transfer/collection sites. In Argentina we own one processing facility, which uses a combination of both incineration and autoclave treatments. In addition, we have technology licensing agreements with companies located in Japan, Brazil, and Australia.

Note 2 Summary of Significant Accounting Policies

Principles of Consolidation:

The consolidated financial statements include the accounts of Stericycle, Inc. and its wholly owned subsidiaries as well as our 64.5% ownership in Medam S.A. de C.V. (Medam) (a Mexican company). All significant intercompany accounts and transactions have been eliminated. In addition, we have a 37.5% ownership in Medam B.A. Srl (an Argentine company), which is accounted for using the equity method. Minority interest expense related to our majority owned subsidiary and our equity interest in the income or loss of our unconsolidated subsidiary are included in the other income (expense).

Revenue Recognition:

We recognize revenue for our regulated waste services at the time of waste collection. Revenues from regulated returns management services are recorded at the time services are performed. Royalty revenues are calculated based on measurements specified in each contract or license and revenues are recognized at the end of each reporting period when the activity being measured has been completed. Revenues from product sales are recognized at the time the goods are shipped to the ordering customer. Software licensing revenues are recognized on a prorated basis over the term of the license agreement. Revenue and costs on contracts to supply our proprietary ETD treatment equipment are recognized based on shipment of equipment and services provided for in the individual contract. We had no revenues related to ETD sales in 2006 or 2005. We do not have any contracts in a loss position. Losses would be recorded when known and estim