SHARPS COMPLIANCE CORP
Form 10QSB
February 01, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

[x] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended December 31, 2005

[ ] TRANSITION REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _______ to ________.

Commission File Number: 0-22390

SHARPS COMPLIANCE CORP.
(Name of small business issuer as specified in its Charter)

Delaware	74-2657168
(State or other jurisdiction of incorporation or organization)	(IRS. Employer Identification No.)

9350 Kirby Drive, Suite 300, Houston, Texas	77054
(Address of principal executive offices)	(Zip Code)

(713) 432-0300
(Issuer's telephone number)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [x]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 10,547,311 shares of Common Stock, $0.01 par value as of February 1, 2006.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [x]

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

CURRENT ASSETS:

Cash and cash equivalents...
Restricted cash...
Accounts receivable, net of allowance for doubtful accounts of $21,352 and $21,757, respectivel
Inventory...
Prepaid and other assets...

TOTAL CURRENT ASSETS..

PROPERTY AND EQUIPMENT, net of accumulated depreciation of $715,003 and $650,532,
respectively...

INTANGIBLE ASSETS, net of accumulated amortization of $105,827 and $102,195, respectively........

TOTAL ASSETS..

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:
Accounts payable..
Accrued liabilities...
Current portion of deferred revenue - incineration......................................
Current portion of deferred revenue - transportation....................................
Current maturities of capital lease obligations...

TOTAL CURRENT LIABILITIES...

LONG-TERM DEFERRED REVENUE - INCINERATION, net of current portion................................

LONG-TERM DEFERRED REVENUE - TRANSPORTATION, net of current portion..............................

OBLIGATIONS UNDER CAPITAL LEASES, net of current maturities......................................

OTHER LIABILITIES...

TOTAL LIABILITIES...

COMMITMENTS AND CONTINGENCIES...

STOCKHOLDERS' EQUITY (DEFICIT)
Common stock, $.01 par value per share; 20,000,000 shares authorized ; 10,547,311
shares issued and outstanding ....
Additional paid-in capital..
Accumulated deficit...

TOTAL STOCKHOLDERS' EQUITY (DEFICIT)..

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)....................................

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

REVENUES:

Distribution, net...
Consulting services...
Environmental services..

TOTAL REVENUES...

COSTS AND EXPENSES:
Cost of revenues..
Selling, general and administrative...
Depreciation and amortization...

TOTAL COSTS AND EXPENSES..

OPERATING INCOME (LOSS)...

Interest expense..

INCOME (LOSS) BEFORE INCOME TAXES..

Income Taxes..

NET INCOME (LOSS)...

NET INCOME (LOSS) PER COMMON SHARE

Basic...

Diluted...

WEIGHTED AVERAGE SHARES USED IN COMPUTING NET INCOME (LOSS) PER COMMON SHARE
Basic...

Diluted...

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

REVENUES:	
Distribution, net..	
Consulting services..	
Environmental services...	
TOTAL REVENUES..	
COSTS AND EXPENSES:	
Cost of revenues...	
Selling, general and administrative................................	
Depreciation and amortization......................................	
TOTAL COSTS AND EXPENSES...	
OPERATING INCOME...	
Interest Expense...	
INCOME BEFORE INCOME TAXES...	
Income Taxes...	
NET INCOME	
NET INCOME PER COMMON SHARE	
Basic..	
Diluted..	
WEIGHTED AVERAGE SHARES USED IN COMPUTING NET INCOME PER COMMON SHARE	
Basic..	
Diluted..	

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

CASH FLOWS FROM OPERATING ACTIVITIES:

Net Income
Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation and amortization
Change In allowance for doubtful accounts
Loss on disposal of equipment
Changes in operating assets and liabilities:
Decrease in restricted cash
(Increase) decrease in accounts receivable
Increase in inventory
(Increase) decrease in prepaids and other assets
Increase (decrease) in accounts payable and accrued liabilities
Increase in deferred revenue

NET CASH PROVIDED BY OPERATING ACTIVITIES

CASH FLOWS FROM INVESTING ACTIVITIES:
Purchases of property and equipment
Disposal of fixed asset
Additions to intangible assets

NET CASH USED IN INVESTING ACTIVITIES

CASH FLOWS FROM FINANCING ACTIVITIES:
Payment on notes payable
Net payments on factoring agreement
Payments on capital lease obligations

NET CASH USED IN FINANCING ACTIVITIES

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS, beginning of period

CASH AND CASH EQUIVALENTS, end of period

NONCASH INVESTING AND FINANCING ACTIVITIES:

Property and equipment additions acquired under capital lease

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

NOTE 1. ORGANIZATION AND BACKGROUND

The accompanying consolidated financial statements include the financial transactions and accounts of Sharps Compliance Corp. and its wholly owned subsidiaries, Sharps Compliance, Inc. of Texas (dba Sharps Compliance, Inc.), Sharps e-Tools.com, Inc. ("Sharps e-Tools"), Sharps Manufacturing, Inc., Sharps Environmental Services, Inc. (dba Sharps Environmental Services of Texas, Inc.) and Sharps Safety, Inc. (collectively, "Sharps" or the "Company"). All significant intercompany accounts and transactions have been eliminated upon consolidation.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") and, accordingly, do not include all information and footnotes required under accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, these interim condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial position of the Company as of December 31, 2005 and the results of its operations and cash flows for the three and six months ended December 31, 2005 and 2004. The results of operations for the three and six months ended December 31, 2005, are not necessarily indicative of the results to be expected for the entire fiscal year ending June 30, 2006. These condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-KSB for the year ended June 30, 2005. Certain prior year amounts have been reclassified to conform to current year presentation.

NOTE 3. REVENUE RECOGNITION

The Company adopted the Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition", which provides guidance related to revenue recognition based on interpretations and practices followed by the SEC. Under SAB No. 101, certain products offered by the Company have revenue producing components that are recognized over multiple delivery points (Sharps Disposal by Mail Systems, referred to as "Mailback" and Sharps Return Boxes, referred to as "Pump Returns") and can consist of up to three separate elements as follows: (1) the sale of the container system, (2) the transportation of the container system and (3) the treatment and disposal (incineration) of the container system. The individual fair value of the transportation and incineration services are determined by the sales price of the service offered by third parties, with the fair value of the container being the residual value. Revenue for the sale of the container is recognized upon delivery to the customer, at which time the customer takes title and assumes

risk of ownership. Transportation revenue on Mailbacks is recognized when the customer returns the mailback container system and the container has been received at the Company's treatment facility. The Mailback container system is mailed to the incineration facility using the United States Postal Service ("USPS"). Incineration revenue is recognized upon the destruction and certification of destruction having been prepared on the container. Since the transportation element and the incineration elements are undelivered services at the point of initial sale of the container, the Mailback revenue is deferred until the services are performed. The current and long-term portions of deferred revenues are determined through regression analysis and historical trends. Furthermore, through regression analysis of historical data, the Company has determined that a certain percentage of all container systems sold may not be returned. Accordingly, a portion of the transportation and incineration elements is recognized at the point of sale.

NOTE 4. INCOME TAXES

During the three and six months ended December 31, 2005 the Company recorded a provision of $3,310 and $8,815, respectively, for estimated Alternative Minimum Tax (AMT). The Company anticipates net operating profits for the year ended June 30, 2006, although no assurance can be given. The Company expects to utilize its net operating loss carryforwards to offset any ordinary taxable income for the year ended June 30, 2006.

NOTE 5. ACCOUNT RECEIVABLE

During September and October 2003, the Company secured judgments against Ameritech Environmental, Inc. ("Ameritech") totaling $176,958 related to the non-payment by Ameritech for services provided by the Company in 2002. Ameritech sold the assets of Ameritech representing collateral for the judgments to MedSolutions, Inc. of Dallas, Texas ("MedSolutions") in November 2003. During January 2004, the Company secured a Garnishment Order against MedSolutons whereby MedSolutions was ordered to pay to the Company $170,765, plus interest at 5%. Payments under the Garnishment Order were scheduled to be made monthly in the amount of $4,375 (inclusive of interest) with a balloon payment of $137,721 due November 7, 2004. MedSolutions is currently in breach of the Garnishment Order. During January 2005, the Company filed suit against MedSolutions and Ameritech in the 234th Judicial District Court of Harris County, Texas. The suit alleges collusion, fraudulent conveyance and fraudulent inducement by and between MedSolutions and Ameritech to defraud payment to the Company for amounts owed, as described above. The Company has also requested the Court to appoint a Receiver for all sums owed to protect assets pending review by the Court. The Company has recently joined two additional creditors for the purpose of petitioning the Court for the involuntary bankruptcy of Ameritech. The Company and the two additional creditors would attempt to recover amounts owed through a court appointed bankruptcy trustee.

In the quarters ending March 31, 2003 and June 30, 2003, the Company wrote-off all outstanding amounts, $75,996 and $106,397 respectively, due from Ameritech. Therefore, any potential future recoveries of receivables would be recorded as a credit to the allowance for bad debts. Collection-related legal fees estimated at one-third of any amounts collected will reduce any recovery that may be received by the Company. Although the Company will continue to aggressively pursue collection of the outstanding amounts under the Garnishment Orders, no assurances regarding collection can be made.

NOTE 6. NOTES PAYABLE AND LONG-TERM DEBT

The Company maintains an arrangement with a financial institution for a $1.25 million asset-based line of credit. The agreement allows the Company to factor customer receivables generated out of its ordinary course of business. The maximum amount available under the line of credit is $1.0 million (or $1.25 million of its gross receivable balance). The agreement automatically renews on an annual basis (August 30 of each year) unless terminated by either party. The Company may borrow up to 80% of the eligible receivables presented and incurs interest on gross invoices financed at a prime rate of interest plus 2%, plus administrative fees of .25% on gross receivables presented. The interest rate decreases to prime plus 1.25% (versus 2%) at such times as the Company's Adjusted Quick Ratio is 1.25 to 1.00 or greater. Adjusted Quick Ratio is defined as cash plus accounts receivable (less than 90 days from invoice date), divided by current liabilities less deferred revenue. During the six-months ended December 31, 2005, there were no borrowings under the arrangement.

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NOTE 7. OBLIGATIONS UNDER CAPITAL LEASES

Capital lease obligations consist of the following:

	Decembe 200
Capital lease for the purchase of accounting and operating system software and hardware, due in monthly installments of $4,061, interest imputed at 21% through February 2007	$ 5
Capital lease for purchase of phone system due in monthly installments of $455, interest imputed at 12% through August 2007	
Capital lease for purchase of copier/printer due in monthly installments of $157, interest imputed at 21% through August 2006	
Capital lease for purchase of phone system upgrades due in monthly installments of $157, interest imputed at 16% through December 2007......	
Capital lease for purchase of forklift due in monthly installments of $290, interest imputed at 11% through July 2007	
Less: current portion	6
	5
	$ 1

NOTE 8. STOCK-BASED COMPENSATION

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation", but elected to continue to account for its employee stock-based compensation plan under Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and its related interpretations in accounting for its stock option plan. While the Company continues to use APB No. 25, pro forma information

regarding net income (loss) and earnings per share is required under SFAS No. 123 and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of SFAS Statement No. 123", including that the information be determined as if the Company had accounted for its stock options under the fair value method prescribed by SFAS No. 123.

The Company uses the Black-Scholes option valuation model to value options granted. Because changes in input assumptions can materially affect the fair value estimate, the existing model may not necessarily provide the only measure of fair value for the employee stock options. The Company used the following weighted-average assumptions for options granted during the quarters ended December 30, 2005 and 2004, as follows: risk-free interest rates of 4.33% and 4.04%, respectively; expected annual dividend yield of 0%; volatility factors of the expected market price of the Company's common stock of approximately 116% and 45%, respectively; and a weighted-average expected life of the options of approximately 2.0 and 4.5 years, respectively.

Had compensation expense for stock based compensation been determined consistent with the provisions of SFAS No. 123 (and as amended by SFAS No. 148), the Company's net income (loss) would have been increased, as follows:

	Three Months Ended December	
	2005	2
	(Unaudited)	(Un
Net income (loss), as reported	$ 166,972	$
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	$ (82,203)	$
Net loss, pro forma	$ 84,769	$
Basic and diluted net loss per share, as reported ..	$ .01	$
Basic and diluted net loss per share, pro forma	$ .01	$

Had compensation expense for stock based compensation been determined consistent with the provisions of SFAS No. 123 (and as amended by SFAS No. 148), the Company's net income (loss) for the six months ended December 31, 2005 and 2004, respectively, would have been increased, as follows:

Six Months Ended December 3	
2005	20

	(Unaudited)	(Unau
Net income, as reported	$ 331,504	$
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	$ (150,110)	$ (
Net loss, pro forma	$ 181,394	$
Basic and diluted net loss per share, as reported ..	$ .02	$
Basic and diluted net loss per share, pro forma	$ .02	$

Stock options issued to consultants or advisors in exchange for services (other than those related to an equity offering) are valued utilizing the Black-Scholes option valuation model and expensed over the corresponding service period.

In December 2004, the FASB issued Statement No. 123 (revised 2004) ("FAS 123 (R)"), Share-Based Payments. FAS 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, such as stock options granted to employees. The Company is required to apply FAS 123 (R) on a modified prospective method. Under this method, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, the Company may elect to adopt FAS 123 (R) by restating previously issued financial statements, basing the amounts on the expense previously calculated and reported in their pro forma disclosures that had been required by FAS 123. For public entities that file as small business issuers (such as the Company), FAS 123 (R) is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005 (quarter ended September 30, 2006).

NOTE 9. EARNINGS PER SHARE

Earnings per share is measured at two levels: basic per share and diluted per share. Basic per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted per share is computed by dividing net income by the weighted average number of common shares after considering the additional dilution related to common stock options. In computing diluted per share, the outstanding common stock options are considered dilutive using the treasury stock method. The following information is necessary to calculate per share for the periods presented:

	Six Months Ende
	2005
Net income, as reported	$ 331,504

Weighted average common shares outstanding......................		10,547,311
Effect of Dilutive stock options...............................		162,033
Weighted average diluted common shares outstanding..............		10,709,344
Net income per common share		
Basic...	$	0.03
Diluted...	$	0.03
Employee stock options excluded from computation of diluted per share amounts because their effect would be anti-dilutive......		2,925,890

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ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-QSB contains certain forward-looking statements and information relating to Sharps that are based on the beliefs of the Company's management as well as assumptions made by and information currently available to the Company's management. When used in this report, the words "anticipate," "believe," "estimate" and "intend" and words or phrases of similar import, as they relate to Sharps or Company management, are intended to identify forward-looking statements. Such statements reflect the current risks, uncertainties and assumptions related to certain factors including, without limitations, competitive factors, general economic conditions, customer relations, relationships with vendors, governmental regulation and supervision, seasonality, distribution networks, product introductions and acceptance, technological change, changes in industry practices, onetime events and other factors described herein. Based upon changing conditions, should any one or more of these risks or uncertainties materialize, or should any underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. The Company does not intend to update these forward-looking statements.

GENERAL

Sharp is a leading developer of cost effective solutions for improving safety, efficiency and cost related to the proper disposal of medical waste by industry and consumers. Sharps primary markets include healthcare, agriculture, hospitality, professional, industrial, commercial, and pharmaceutical. The Company's products and services represent solutions for industries and consumers dealing with the complexity of managing regulatory compliance, environmental sensitivity, employee and customer safety, corporate risk and operating costs related to medical waste disposal. Sharps is a leading proponent and participant in the development of public awareness and solutions for the safe disposal of needles, syringes and other sharps in the community setting.

The Company's primary products include Sharps Disposal by Mail System(R), Pitch-It(TM) IV Poles, Trip LesSystem(R), Sharps Pump Return Box, Sharps Enteral Pump Return Box, Sharps Secure(R), Sharps SureTemp Tote(R), IsoWash(R) Linen Recovery System, Biohazard Spill Clean-Up Kit and Disposal System, Sharps

e-Tools, Sharps Environmental Services and Sharps Consulting. Some products and services facilitate compliance with state and federal regulations by tracking, incinerating and documenting the disposal of medical waste. Additionally, some products and services facilitate compliance with educational and training requirements required by federal, state, and local regulatory agencies.

RESULTS OF OPERATIONS

The following analyzes changes in the consolidated operating results and financial condition of the Company during the three months and six months ended December 31, 2005 and 2004.

The following table sets forth, for the periods indicated, certain items from the Company's Condensed Consolidated Statements of Operations, expressed as a percentage of revenue:

	Three Months Ended December 31,		Six M Dec
	2005	2004	2005
Net revenues	100%	100%	100%
Costs and expenses:			
Cost of revenues	(56%)	(60%)	(57%)
Selling, general and administrative	(36%)	(38%)	(35%)
Depreciation and amortization	(1%)	(2%)	(1%)
Total operating expenses	(93%)	(100%)	(93
Income (loss) from operations	7%	0%	7
Total other income (expense)	(1)%	0%	(1
Net income	6%	0%	6%

THREE MONTHS ENDED DECEMBER 31, 2005, COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2004

Total revenues for the three months ended December 31, 2005 of $2,663,376 increased by $434,331, or 19%, over the total revenues for the three months ended December 31, 2004 of $2,229,045. The increase in revenues is attributable to increased billings in the Agriculture ($132,720), Healthcare ($118,124), Pharmaceutical ($95,172), Retail ($47,864) and Professional ($40,250) markets. The increase in billings in all markets is being driven by higher demand for the Company's products as a result of the Company's marketing efforts and as industry and consumers become more aware of the proper disposal of medical sharps (syringes, lancets, etc.). Additionally, the increase in billings in the Retail market is a result of the use of our products in grocery store and pharmacies to properly dispose of syringes utilized to administer flu shots and other inoculations. The increase in billings in the Pharmaceutical market is a result of the demand for our products in the clinical trial setting.

Cost of revenues for the three months ended December 31, 2005 of $1,496,692 were 56% of revenues which were lower than the cost of sales of 60% during the

corresponding period of the prior year. The reduction in cost of sales (and corresponding increase in the gross margin) is due to the increase in revenues as described in the preceding paragraph and the mix of product sold.

Selling, general and administrative ("S, G & A") expenses for the three months ended December 31, 2005 of $957,484, increased by $96,463, or 11%, versus $861,021 for the corresponding period of the previous year. The increase in the S, G & A is primarily a result of increases in the following expenses: (i) professional fees ($41,687), (ii) compensation related ($26,102), and (iii) travel ($19,543). The increase in professional fees is related to Company litigation and advisory fees. The increase in compensation and travel expenses are a result of the increase in the Company's sales and marketing efforts.

SIX MONTHS ENDED DECEMBER 31, 2005, COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2004

Total revenues for the six months ended December 31, 2005 of $5,323,488 increased by $675,057, or 15%, over the total revenues for the six months ended December 31, 2004 of $4,648,431. The increase in revenues is primarily attributable to increased billings in the Retail ($237,237), Hospitality ($159,658), Agriculture ($122,788) and Pharmaceutical ($95,172) markets. The increase in billings in all markets is being driven by higher demand for the Company's products as industry and consumers become more aware of the proper disposal of medical sharps (syringes, lancets, etc.). Additionally, the increase in billings in the Retail market is a result of the use of our products in grocery store and pharmacies to properly dispose of syringes utilized to administer flu shots and other inoculations. The increase in the Hospitality market billings is a result of an approximate $100,000 order from one of the nation's largest contract food service providers for the Company's biohazard spill clean-up kit. The increase in billings in the Pharmaceutical market is a result of the demand for our products in the clinical trial setting.

Cost of revenues for the six months ended December 31, 2005 of $3,057,611 were 57% of revenues which were lower than the cost of sales of 60% during the corresponding period of the prior year. The reduction in cost of sales (and corresponding increase in the gross margin) is due to the increase in revenues as described in the preceding paragraph and the mix of product sold.

Selling, general and administrative ("S, G & A") expenses for the six months ended December 31, 2005 of $1,849,860, increased by $120,934, or by 7%, versus $1,728,926 for the corresponding period of the prior year. . The increase in the S, G & A is primarily a result of increases in the following expenses: (i) professional fees ($55,552), (ii) compensation related ($30,365), and (iii) travel ($8,814). The increase in professional fees is related to Company litigation and advisory fees. The increase in compensation and travel expenses are a result of the increase in the Company's sales and marketing efforts.

PROSPECTS FOR THE FUTURE

The Company continues to take advantage of the many opportunities in the markets served as consumers and industries become more aware of the proper disposal of medical sharps (syringes, lancets, etc.). This education process was substantially strengthened in December 2004 when the U. S. Environmental Protection Agency ("EPA") issued its new guidelines for the proper disposal of medical sharps (see www.epa.gov/epaoswer/other/medical/sharps.htm). Among the recommended methods of disposal are mail-back programs and products such as that marketed by the Company.

Although the Company's largest market has historically been Healthcare, we believe the most significant long-term growth opportunities are in the Agriculture, Pharmaceutical, Retail, Commercial and Hospitality markets. In

order to more effectively address these opportunities, the Company has recently re-aligned its sales force whereby each regional sales director markets all Company products across multiple market segments within his or her geographic territory.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by $149,213 to $407,640 at December 31, 2005 from $258,427 at June 30, 2005. The increase in cash and cash equivalents is primarily a result of the strong operating earnings and corresponding cash flow from operations of $302,834, offset by, (i) additions to property and equipment of $76,832, (ii) additions to intangible assets of $53,624 and (iii) payments on capital lease obligations of $23,165.

Accounts receivable increased by $99,322 to $1,063,875 at December 31, 2005 from $964,148 at June 30, 2005. The increase was consistent with the increase in revenues during the quarter ending December 2005 of $2,663,376 as compared to the revenues during the quarter ending June 2005 of $2,120,102.

Property and equipment increased by $12,361 to $450,425 at December 31, 2005 from $438,064 at June 30, 2005. This increase is attributable to capital expenditures of $76,832 for the six months ended December 31, 2005 offset by the depreciation expense for the same period of $64,471. The capital expenditures represent capital costs spent on the Company's incineration facility in Carthage, Texas as well as computer, software and other equipment at the Company's corporate offices in Houston, Texas.

Intangible assets increased by $49,992 to $61,771 at December 31, 2005 from $11,779 at June 30, 2005. This increase is attributable to permit-related expenditures totaling $53,624 associated with the Company's incineration facility in Carthage, Texas offset by amortization expense of $3,632.

Management believes that the Company's current cash resources along with cash from operations and its asset-based factoring line of credit will be sufficient to fund operations for the twelve months ended December 31, 2006.

TRENDS

Consistent with the recent revenue growth (19% and 15% for the three and six months ended December 31, 2005, respectively), the trend of earnings and cash from operations has been very positive. The Company's internal plans contemplate additional growth in all of its markets served. While the Company has no material expected change in the level of capital expenditures in the near-term, it may incur significant capital costs should it decide to upgrade its current incineration facility in Carthage, Texas in order to comply with the November 2005 amended EPA Clean Air Act (see INCINERATOR FACILITY- REGULATORY DEVELOPMENTS below). The Company could avoid such upgrade and the associated capital costs should it decide to install alternative technology (at a much lower cost) or outsource its incineration needs (no additional capital costs). The Company has studied the amended EPA Clean Air Act and its options, but has not yet made a decision as to which alternative it will pursue. It is important to note that should the Company decide to upgrade its incineration facility to comply with the new regulations or install alternative technology, it would open up the opportunity for additional revenue sources including hospital medical waste disposal. As noted below, the new regulation allows a minimum period of three years and a maximum of five years to comply.

CRITICAL ACCOUNTING ESTIMATES

Certain products offered by the Company have revenue producing components that are recognized over multiple delivery points and can consist of up to three separate elements as follows: (1) the sale of the container system, (2) the transportation of the container system and (3) the treatment and disposal (incineration) of the container system. Since the transportation element and the incineration elements are undelivered services at the point of initial sale of the container, the revenue is deferred until the services are performed. The current and long-term portions of deferred revenues are determined through regression analysis and historical trends. Furthermore, through regression analysis of historical data, the Company has determined that a certain percentage of all container systems sold may not be returned. Accordingly, a portion of the transportation and incineration elements is recognized at the point of sale.

INCINERATOR FACILITY- REGULATORY DEVELOPMENTS

In November 2005, the EPA amended the Clean Air Act which will effect the operations of the Company's leased incineration facility located in Carthage, Texas. The regulation modifies the emission limits and monitoring procedures required to operate an incineration facility. The new rules will necessitate changes to the Company's leased incinerator and pollution control equipment at the facility or require installation of an alternative treatment method to ensure compliance. Such change would require the Company to incur significant capital expenditures in order to meet the requirements of the regulations. The regulation allows a minimum period of three years and a maximum of five years to comply. The Company has studied the amended EPA Clean Air Act and its options, but has not yet made a decision. It is important to note that should the Company decide to upgrade its incineration facility to comply with the new regulations or install alternative technology, it would open up the opportunity for additional revenue sources including hospital medical waste disposal.

RECENTLY ISSUED ACCOUNTING STANDARDS

In November 2004, the FASB issued FASB Statement No. 151, which revised ARB No.43, relating to inventory costs. This revision is to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). This Statement requires that these items be recognized as a current period charge regardless of whether they meet the criterion specified in ARB 43. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after the date of this Statement is issued. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

In December 2004, the FASB issued FASB Statement No. 152, which amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, Accounting for Real Estate Time-Sharing Transactions. This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real-estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Management

believes this Statement will have no impact on the financial statements of the Company once adopted.

In December 2004, the FASB issued FASB Statement No. 153. This Statement addresses the measurement of exchanges of nonmonetary assets. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges incurred during fiscal years beginning after the date of this Statement is issued. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

In December 2004, the FASB issued Statement No. 123 (revised 2004) ("FAS 123 (R)"), Share-Based Payments. FAS 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, such as stock options granted to employees. The Company is required to apply FAS 123 (R) on a modified prospective method. Under this method, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, the Company may elect to adopt FAS 123 (R) by restating previously issued financial statements, basing the amounts on the expense previously calculated and reported in their pro forma disclosures that had been required by FAS 123. For public entities that file as small business issuers, FAS 123 (R) is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005 (quarter ended September 30, 2006). Management has not completed its evaluation of the effect that FAS 123 (R) will have, but believes that the effect will be consistent with the application disclosed in its pro forma disclosures (Note 8 of the Notes to the Condensed Consolidated Financial Statements).

In May 2005, the FASB issued Statement No. 154, Accounting Changes & Error Corrections, which replaced APB Opinion No. 20 and FASB Statement No. 3. This statement changes the requirement for accounting and reporting of a voluntary change in accounting principle and changes required by an accounting pronouncement when the specific transition provisions are absent. This statement requires retrospective application to prior periods' financial statements of changes in accounting principle. If it is impracticable to determine either the period-specific effect or the cumulative effect of the change, this statement requires that the new accounting principle be adopted prospectively from the earliest practicable date. SFAS No. 154 is effective in the period that begins after December 15, 2005, and early adoption is permitted in the fiscal years beginning after SFAS No. 154 was issued. The Company does not expect the new standard to have any material impact on our financial position and results of operations.

ITEM 3. CONTROLS AND PROCEDURES

As of the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13(a)-15(e) and 15(d) - 15(e). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are

effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the Company's evaluation.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

During September and October 2003, the Company secured judgments against Ameritech Environmental, Inc. ("Ameritech") totaling $176,958 related to the non-payment by Ameritech for services provided by the Company in 2002. Ameritech sold the assets of Ameritech representing collateral for the judgments to MedSolutions, Inc. of Dallas, Texas ("MedSolutions") in November 2003. During January 2004, the Company secured a Garnishment Order against MedSolutons whereby MedSolutions was ordered to pay to the Company $170,765, plus interest at 5%. Payments under the Garnishment Order were scheduled to be made monthly in the amount of $4,375 (inclusive of interest) with a balloon payment of $137,721 due November 7, 2004. MedSolutions is currently in breach of the Garnishment Order. During January 2005, the Company filed suit against MedSolutions and Ameritech in the 234th Judicial District Court of Harris County, Texas. The suit alleges collusion, fraudulent conveyance and fraudulent inducement by and between MedSolutions and Ameritech to defraud payment to the Company for amounts owed, as described above. The Company has also requested the Court to appoint a Receiver for all sums owed to protect assets pending review by the Court. The Company has recently joined two additional creditors for the purpose of petitioning the Court for the involuntary bankruptcy of Ameritech. The Company and the two additional creditors would attempt to recover amounts owed through a court appointed bankruptcy trustee.

In the quarters ending March 31, 2003 and June 30, 2003, the Company wrote-off all outstanding amounts, $75,996 and $106,397 respectively, due from Ameritech. Therefore, any potential future recoveries of receivables would be recorded as a credit to the allowance for bad debts. Collection-related legal fees, estimated at one-third of any amounts collected, will reduce any recovery that may be received by the Company. Although the Company will continue to aggressively pursue collection of the outstanding amounts under the Garnishment Orders, no assurances regarding collection can be made.

On June 14, 2004, the Company provided Mr. Ronald E. Pierce, its then current Chief Operating Officer ("Mr. Pierce"), with notice of non-renewal of his employment agreement. As such, July 14, 2004 was Mr. Pierce's last day of employment. The Company has advised Mr. Pierce that under the terms of the employment contract no further compensation (including services) was due. The Company then received various letters from Mr. Pierce's attorney advising that Mr. Pierce is taking the position that the non-renewal of the employment agreement was not timely and, therefore, Mr. Pierce was terminated without cause. Additionally, Mr. Pierce claims that the Company had no right to terminate him on the anniversary date of his agreement without the obligation of paying Mr. Pierce as if he were terminated without cause. Mr. Pierce has demanded severance related payments totaling approximately $280,000 (including an $80,000 bonus) along with the full accelerated vesting of 500,000 stock options previously awarded to Mr. Pierce. The Company believes that notice of such non-renewal was timely, and that in accordance with Mr. Pierce's employment agreement, the Company was entitled to provide notice thirty (30) days prior to the anniversary of its intent to terminate the agreement, and no severance would therefore be due to Mr. Pierce. On July 30, 2004, the Company received notice

from Mr. Pierce's attorney requesting commencement of arbitration to resolve the claim. No further communications have been received from Mr. Pierce's attorney since July 30, 2004. The Company believes it has meritorious defenses against Mr. Pierce's claims and has not recorded a liability related to this matter.

On or about February 25, 2003, Jason Jodway, a then employee of the Company since April 1999, resigned in lieu of termination of employment by the Company. Thereafter, Mr. Jodway formed Attentus Medical Sales, Inc., a competing entity of the Company. In March 2005, the Company's wholly-own subsidiary Sharps Compliance, Inc., filed a lawsuit in Harris County District Court, Texas against Mr. Jodway and Attentus Medical Sales, Inc. The lawsuit claims, (i) breach of a confidentiality agreement, (ii) misappropriation of trade secrets and (iii) tortious interference with the Company's existing and prospective contracts and business relationships. On April 7, 2005, the defendant filed its answer and counter claims against Sharps Compliance, Inc. asserting breach of contract, quantum merit and violation of the Texas Payday Act alleging that his last day of employment was March 29, 2003 and that he is entitled to receive two weeks of back wages and commissions. On September 19, 2005, the Company amended its pleadings and added claims asserting conversion, unjust enrichment, unfair competition and trademark infringement in violation of the Lanham Act, false advertising in violation of the Lanham Act, trademark dilution under the Texas Business and Commerce Code, and tortious interference with existing and/or prospective customers. On April 28, 2005, Defendants filed an Amended Answer and Counterclaims adding counter claims asserting slander, business disparagement and tortious interference with contractual and prospective relationships. On April 29, 2005, Mr. Jodway and Attentus Medical Sales, Inc. filed a Notice of Removal of the action from Harris County Circuit Court to the United States District Court, Southern District of Texas. The Company denies any obligation to Mr. Jodway for his back wages, commissions and denies all other allegations. The Company intends to vigorously pursue its affirmative claims against Mr. Jodway and Attentus Medical Sales, Inc., seek injunctive relief for violations of the Lanham Act, money damages and attorneys fees, although the Company has not quantified its damages to date.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On November 17, 2005, the Company held its Annual Meeting of shareholders whereby the following items were voted upon, (i) the election of six directors to hold office until the next annual shareholders meeting, (ii) an amendment to the Company's 1993 Stock Plan to increase the shares available under the Plan by 500,000 and (iii) other matters that may be presented at the meeting for action.

The following Directors were elected at the meeting, (i) Dr. Burt Kunik, (ii) Ramsay Gillman, (iii) John R. Grow, (iv) Parris H. Holmes, Jr., (v) F. Gardner Parker and (vi) Philip C. Zerrillo. Additionally, the shareholders approved the amendment to the Company's 1993 Stock Plan to increase the shares available under the Plan by 500,000 to 3.5 million.

As of September 29, 2005, the record date of the Annual Meeting, 10,547,311 shares of common stock were outstanding. At the Annual Meeting, holders of 8,287,288 shares of common stock were present in person or represented by proxy. The following sets forth information regarding the results of the voting at the Annual Meeting.

Proposal I - Election of Directors

	Votes in Favor	Votes Withh

Dr. Burt Kunik	8,287,288	67,
Ramsay Gillman	8,287,288	67,
John R. Grow	8,287,288	67,
Parris H. Holmes, Jr.	8,104,288	250,
F. Gardner Parker	8,287,288	67,
Philip C. Zerrillo	8,287,288	67,

Proposal II - Amendment to the Company's 1993 Stock Plan

Votes in favor	7,980,576
Votes against	373,624
Abstentions	157

ITEM 6. EXHIBITS

(a) Exhibits:

31.1	Certification of Chief Executive Officer in Accordance with Section 302 of the Sarbanes-Oxley Act (filed herewith)
31.2	Certification of Chief Financial Officer in Accordance with Section 302 of the Sarbanes-Oxley Act (filed herewith)
32.1	Certification of Chief Executive Officer in Accordance with Section 906 of the Sarbanes-Oxley Act (filed herewith)
32.2	Certification of Chief Financial Officer in Accordance with Section 906 of the Sarbanes-Oxley Act (filed herewith)

ITEMS 2, 3, AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REGISTRANT:

SHARPS COMPLIANCE CORP.

Dated: February 1, 2006

By: /s/ Dr. Burton J. Kunik

Chairman of the Board, Chief Executive Officer and President

Dated: February 1, 2006

By: /s/ David P. Tusa

Executive Vice President,
Chief Financial Officer
Business Development &
Corporate Secretary

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