SHARPS COMPLIANCE CORP
Form 10QSB
May 08, 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 March 31, 2006

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.
(Exact name of small business issuer as specified in its charter)

Delaware	74-2657168
(State or other jurisdiction of incorporation or organization)	(I.R.S. 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: 10,548,810 shares of Common Stock, $0.01 par value as of May 8, 2006.

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	Ma (Una
CURRENT ASSETS:	
Cash and cash equivalents	$
Restricted cash	
Accounts receivable, net of allowance for doubtful accounts of $20,111 and $21,757, respectively	
Inventory	
Prepaid and other assets	
TOTAL CURRENT ASSETS	

PROPERTY AND EQUIPMENT, net of accumulated depreciation of $752,213 and $650,532, respectively	
INTANGIBLE ASSETS, net of accumulated amortization of $111,246 and $102,195, respectively.	------
TOTAL ASSETS	$
	======
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	
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; 10,548,810 and 10,547,311 shares issued and outstanding, respectively	
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

For the Three Months

	Ended March 31, 2006	2005
	(Unaudited)	
REVENUES:		
Distribution, net	$ 2,401,158	$ 2,123,791
Consulting services	7,148	5,921
Environmental services	122,904	102,932
TOTAL REVENUES	2,531,210	2,232,644
COSTS AND EXPENSES:		
Cost of revenues	1,466,906	1,398,141
Selling, general and administrative	1,024,505	894,205
Depreciation and amortization	42,629	37,798
TOTAL COSTS AND EXPENSES	2,534,040	2,330,144
OPERATING LOSS	(2,830)	(97,500)
OTHER INCOME EXPENSES:		
Interest income	3,262	1,711
Interest expense	(2,945)	(5,123)
TOTAL OTHER INCOME (EXPENSES)	317	(3,412)
LOSS BEFORE INCOME TAXES	(2,513)	(100,912)
Income Taxes	-	4,693
NET LOSS	$ (2,513)	$ (96,219)
NET LOSS PER COMMON SHARE		
Basic	$ -	$ (.01)
Diluted	$ -	$ (.01)
WEIGHTED AVERAGE SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE		
Basic	10,547,827	10,538,144
Diluted	10,547,827	10,538,144

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

SHARPS COMPLIANCE CORP. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Nine Months Ended March 31,	
	2006	2005
	(Unaudited)	
REVENUES:		
Distribution, net	$ 7,576,365	$ 6,609,598
Consulting services	11,663	28,744
Environmental services	266,671	242,733
TOTAL REVENUES	7,854,699	6,881,075
COSTS AND EXPENSES:		
Cost of revenues	4,524,517	4,116,632
Selling, general and administrative	2,879,355	2,624,776
Depreciation and amortization	110,732	121,054
TOTAL COSTS AND EXPENSES	7,514,604	6,862,462
OPERATING INCOME	340,095	18,613
OTHER INCOME EXPENSES:		
Interest income	8,251	3,356
Interest expense	(10,539)	(18,411)
TOTAL OTHER INCOME (EXPENSES)	(2,288)	(15,055)
INCOME BEFORE INCOME TAXES	337,807	3,558
Income Taxes	(8,815)	-
NET INCOME	$ 328,992	$ 3,558
NET INCOME PER COMMON SHARE		
Basic	$ .03	$ -
Diluted	$ .03	$ -
WEIGHTED AVERAGE SHARES USED IN COMPUTING NET INCOME PER COMMON SHARE		
Basic	10,547,481	10,538,144
Diluted	10,814,019	10,980,340

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

	For the Nin Ended Ma
	2006
CASH FLOWS FROM OPERATING ACTIVITIES:	(Unau
Net Income	$ 328,992
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	110,732
Bad debt expense	--
Loss on disposal of equipment	--
Changes in operating assets and liabilities:	
Decrease in restricted cash	--
Decrease in accounts receivable	96,264
(Increase) decrease in inventory	1,180
(Increase) decrease in prepaids and other assets	(374)
Decrease) in accounts payable and accrued liabilities	(182,583)
Increase (decrease) in deferred revenue	(31,566)
NET CASH PROVIDED BY OPERATING ACTIVITIES	322,645
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(144,621)
Disposal of property and equipment	--
Additions to intangible assets	(60,308)
NET CASH USED IN INVESTING ACTIVITIES	(204,929)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Payment on notes payable	--
Net payments on factoring agreement	--
Payments on capital lease obligations	(35,581)
Issuance of common stock	1,141
NET CASH USED IN FINANCING ACTIVITIES	(34,440)
NET INCREASE IN CASH AND CASH EQUIVALENTS	83,276
CASH AND CASH EQUIVALENTS, beginning of period	258,427
CASH AND CASH EQUIVALENTS, end of period	$ 341,703
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

March 31, 2006

NOTE 1. ORGANIZATION AND BACKGROUND

The accompanying consolidated financial statements include the financial transactions and accounts of Sharps Compliance Corp. and it's 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 of America 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 March 31, 2006 and the results of its operations and cash flows for the three and nine months ended March 31, 2006 and 2005. The results of operations for the three and nine months ended March 31, 2006, 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 nine months ended March 31, 2006 the Company recorded a provision of $0 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. LINE OF CREDIT

On March 27, 2006, the Company entered into a Credit Agreement with JPMorgan Chase Bank, N.A. which provides for a $1.5 million Line of Credit Facility the proceeds of which may be utilized for, (i) for working capital, (ii) letters of credit (up to $200,000), (iii) acquisitions (up to $500,000) and (iv) general corporate purposes. Indebtedness under the Credit Agreement is secured by substantially all of the Company's assets. Borrowings bear interest at a fluctuating rate per annum equal to either, (i) prime rate or (ii) LIBOR plus a margin of 2.50%. Any outstanding revolving loans, and accrued and unpaid interest, will be due and payable on March 27, 2008, the maturity date of the facility. The aggregate principal amount of advances outstanding at any time under the Facility shall not exceed the Borrowing Base which is equal to, (i) 80% of Eligible Accounts Receivable (as defined) plus (ii) 50% of Eligible Inventory (as defined). The Credit Agreement contains affirmative and negative covenants that, among other items, require the Company to maintain a specified tangible net worth and fixed charge coverage ratio. The Credit Agreement also contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, the lenders' commitment to make further loans may terminate and the Borrower may be required to make immediate repayment of all indebtedness to the lenders. The lender would also be entitled to pursue other remedies against the Company and the collateral. As of March 31, 2006, there were no borrowings under this Line Of Credit Facility.

The above noted Line of Credit Facility replaces the Company's previous arrangement with a financial institution for a $1.25 million asset-based (accounts receivable factoring) line of credit.

NOTE 7. OBLIGATIONS UNDER CAPITAL LEASES

Capital lease obligations consist of the following:

	March 31, 2006	June 3 2005
Capital lease for the purchase of accounting and operating system software and hardware, due in monthly installments of $4,061, interest imputed at 21% through February 2007......................$	40,432	$ 68
Capital lease for purchase of phone system due in monthly installments of $455, interest imputed at 12% through August 2007..	7,080	10
Capital lease for purchase of copier/printer due in monthly installments of $157, interest imputed at 21% through August 2006..	602	1
Capital lease for purchase of phone system upgrades due in monthly installments of $157, interest imputed at 16% through March 2007...	2,895	3
Capital lease for purchase of forklift due in monthly installments of $290, interest imputed at 11% through July 2007.................	4,080	6

	55,089	90
Less: current portion	50,677	48
	$ 4,412	$ 42

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 March 30, 2006 and 2005, as follows: risk-free interest rates of 4.7% and 4.33%, respectively expected annual dividend yield of 0%; volatility factors of the expected market price of the Company's common stock of approximately 122% and 50%, respectively; and a weighted-average expected life of the options of 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 loss would have been increased, as follows:

	Three Months Ended March 31,	
	2006	2005
	(Unaudited)	(Unaudited)
Net loss, as reported	$ (2,513)	$ (96,219)
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	$ (77,270)	$ (66,473)
Net loss, pro forma	$ (79,783)	$ (162,692)
Basic and diluted net loss per share, as reported	$ -	$ (.01)
Basic and diluted net loss per share, pro forma	$ (.01)	$ (.02)

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 for the nine months ended March 31, 2006 and 2005, respectively, would have been decreased, as follows:

	Nine Months Ended March 31,	
	2006	2005
	(Unaudited)	(Unaudited)
Net income, as reported.......................	$ 328,992	$ 3,558
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects.......................................	$ (227,380)	$ (197,520)
Net income (loss), pro forma..................	$ 101,612	$ (193,962)
Basic and diluted net income per share, as reported	$ .03	$ -
Basic and diluted net income (loss) per share, pro forma	$ .01	$ (.01)

Stock options issued 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 has elected 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. 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 of the first fiscal year beginning on or after December 15, 2005 (quarter ended September 30, 2006). Management has completed its evaluation of the effect that FAS 123 (R) will have and 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).

NOTE 9. EARNINGS PER SHARE

Earnings per share are 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 (unaudited):

	Nine Months Ended March 31,	
	2006	2005
Net income, as reported............................	$ 328,992	$ 3,558
Weighted average common shares outstanding...........	10,547,481	10,538,144
Effect of Dilutive stock options....................	266,538	442,196
Weighted average diluted common shares outstanding...	10,814,019	10,980,340
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 dilutive..	2,478,890	2,218,890

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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

Sharps is a leading developer of cost effective solutions for improving safety, efficiency and costs 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 nine months ended March 31, 2006 and 2005.

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 (unaudited):

	Three Months Ended March 31,		Nine M Ma
	2006	2005	2006
Net revenues	100%	100%	100%
Costs and expenses:			
Cost of revenues	(58%)	(63%)	(58%)
Selling, general and administrative	(40%)	(40%)	(37%)
Depreciation and amortization	(2%)	(2%)	(1%)
Total operating expenses	(100%)	(105%)	(96%)
Income (loss) from operations	0%	(5%)	4%
Total other income	0%	0%	0%
Net income (loss)	0%	(4%)	4%

THREE MONTHS ENDED MARCH 31, 2006, COMPARED TO THREE MONTHS ENDED MARCH 31, 2005

Total revenues for the three months ended March 31, 2006 of $2,531,210 increased by $298,566, or 13%, over the total revenues for the three months ended March 31, 2005 of $2,232,644. The increase in revenues is primarily attributable to increased billings in the Retail ($53,411), and Government ($38,990), Professional ($35,099) and Hospitality ($29,669) markets. Also positively effecting revenue for the quarter ended March 31, 2006 was the increase in reported revenue resulting from the effects of the Company's revenue recognition method (See Note 3 of the notes to unaudited consolidated financial statements). These increases were partially offset by decreased billings in the Healthcare market of $106,444. The increase in billings in the Professional and Hospitality markets is being driven higher by demand for the Company's products as industry and consumers become more aware of the proper disposal of medical sharps (syringes, lancets, etc.). The increase in revenue in the Government market is attributable to the billings associated with a three year award received by the Company during the quarter from an agency of the United States Government. The increase in the billings in the Retail market is a result of the use of our products in grocery stores and pharmacies to properly dispose of syringes utilized to administer flu and other inoculations. The decrease in the billings in the Healthcare market is primarily attributable to the effect of ordering patterns by home healthcare customers.

Cost of revenues for the three months ended March 31, 2006 of $1,466,906 were 58% of revenues were lower than the cost of sales of 63% 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 coupled with the mix of product sold.

Selling, general and administrative ("S, G & A") expenses for the three months ended March 31, 2006 of $1,024,505, increased by $130,300, or 15%, versus $894,205 for the corresponding period of the previous year. The increase in S,G&A is a result of increases in the following expenses: (i) compensation related ($54,907), (ii) professional fees ($46,670), and (iii) travel ($18,512). The increase in compensation and travel expenses are a result of the increase in the Company's employed sales persons and travel related expenses. The increase in professional fees is related to Company litigation and advisory fees.

NINE MONTHS ENDED MARCH 31, 2006, COMPARED TO NINE MONTHS ENDED MARCH 31, 2005

Total revenues for the nine months ended March 31, 2006 of $7,854,699 increased by $973,624, or 14%, over the total revenues for the nine months ended March 31, 2005 of $6,881,075. The increase in revenues is primarily attributable to increased billings in the Retail ($290,649), Hospitality ($189,326), Agriculture ($125,592), and Professional ($99,018) 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 stores and pharmacies to properly dispose of syringes utilized to administer flu 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 nine months ended March 31, 2006 of $4,524,517 were 58% of revenues versus $4,116,632, or 60% of the revenues for the corresponding period of the previous year. The reduction in cost of sales (and corresponding increase in the gross margin) is due to the increase in revenues coupled with the mix of product sold.

Selling, general and administrative ("S, G & A") expenses for the nine months ended March 31, 2006 of $2,879,355, increased by $254,579, or by 10%, versus $2,624,776 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) compensation related ($85,272), (ii) professional fees ($102,221), and (iii) travel ($27,326). The increase in compensation and travel expenses are a result of the increase in the Company's employed sales persons and travel related expenses.. The increase in professional fees is related to Company litigation and advisory fees.

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 March 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 $83,276 to $341,703 at March 31, 2006 from $258,427 at June 30, 2005. The increase in cash and cash equivalents is primarily a result of operating earnings and corresponding cash flow from operations of $322,645, partially offset by, (i) additions to property and equipment of $144,621, (ii) additions to intangible assets of $60,308 and (iii) payments on capital lease obligations of $35,581.

Accounts receivable decreased by $96,264 to $867,884 at March 31, 2006 from $964,148 at June 30, 2005. The decrease was a result in the timing of collection of customer payments.

Property and equipment increased by $42,940 to $481,004 at March 31, 2006 from $438,064 at June 30, 2005. This increase is attributable to capital expenditures of $144,621 for the nine months ended March 31, 2006 partially offset by the depreciation expense for the same period of $101,681. The capital expenditures represent computer and equipment at the Company's corporate offices in Houston, Texas plus capital costs incurred at the incineration facility in Carthage, Texas.

Intangible assets increased by $51,257 to $63,036 at March 31, 2006 from $11,779 at June 30, 2005. This increase is attributable to permit-related expenditures totaling $60,308 associated with the Company's incineration facility in Carthage, Texas partially offset by amortization expense of $9,051.

On March 27, 2006, the Company entered into a Credit Agreement with JPMorgan Chase Bank, N.A. which provides for a $1.5 million Line of Credit Facility the proceeds of which may be utilized for, (i) for working capital, (ii) letters of credit (up to $200,000), (iii) acquisitions (up to $500,000) and (iv) general corporate purposes. Indebtedness under the Credit Agreement is secured by substantially all of the Company's assets. Borrowings bear interest at a fluctuating rate per annum equal to either, (i) prime rate or (ii) LIBOR plus a margin of 2.50%. Any outstanding revolving loans, and accrued and unpaid interest, will be due and payable on March 27, 2008, the maturity date of the facility. The aggregate principal amount of advances outstanding at any time under the Facility shall not exceed the Borrowing Base which is equal to, (i) 80% of Eligible Accounts Receivable (as defined) plus (ii) 50% of Eligible Inventory (as defined). The Credit Agreement contains affirmative and negative covenants that, among other items, require the Company to maintain a specified tangible net worth and fixed charge coverage ratio. The Credit Agreement also contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, the lenders' commitment to make further loans may terminate and the Borrower may be required to make immediate repayment of all indebtedness to the lenders. The lender would also be entitled to pursue other remedies against the Company and the collateral. As of March 31, 2006, there were no borrowings under this Line Of Credit Facility.

The above noted Line of Credit Facility replaces the Company's previous arrangement with a financial institution for a $1.25 million asset-based (accounts receivable factoring) line of credit.

Management believes that the Company's current cash resources along with cash from operations and its line of credit (Note 6) will be sufficient to fund operations for the twelve months ended March 31, 2007.

TRENDS

Consistent with the recent revenue growth (13% and 14% for the three and nine months ended March 31, 2006, 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 cost should it decide to upgrade its current incineration facility in Carthage, Texas consistent 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. 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 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 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 after the date the final rule was published. 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 medical waste disposal.

RECENTLY ISSUED ACCOUNTING STANDARDS

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 has elected 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. 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 of the first fiscal year beginning on or after December 15, 2005 (quarter ended September 30, 2006). Management has completed its evaluation of the effect that FAS 123 (R) will have and 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 February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." which amends SFAS No. 133 and SFAS No. 140. SFAS No. 155 permits hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of income. The fair value election may be applied on an instrument-by-instrument basis. SFAS No. 155 also eliminates a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. SFAS No. 155 is effective for those financial instruments acquired or issued after December 1, 2006. At adoption, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument will be recognized as a cumulative-effect adjustment to beginning retained earnings. The Company does not expect the new standard to have any material impact on our financial position and results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140." SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The standard permits an entity to subsequently measure each class of servicing assets or servicing liabilities at fair value and report changes in fair value in the statement of income in the period in which the changes occur. SFAS No. 156 is effective for the Company as of December 1, 2006. 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.

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 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, 4, AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.

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 thereto duly authorized.

REGISTRANT:

SHARPS COMPLIANCE CORP.

Dated: May 8, 2006

By: /s/ Dr. Burton J. Kunik
Chairman of the Board, Chief Executive Officer and President

Dated: May 8, 2006

By: /s/ David P. Tusa
Executive Vice President,

Chief Financial Officer
Business Development &
Corporate Secretary

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