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SCSC - Q2 2015 ScanSource Inc Earnings Call

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PRESENTATION

Operator

Welcome to the ScanSource quarterly earnings conference call. (Operator Instructions). Today's call is being recorded. (Operator Instructions). I would now like to turn the call over to Mary Gentry, Vice President, Treasurer and Investor Relations. Ma'am, you may begin.

Mary Gentry - ScanSource, Inc. - VP, Treasurer & IR

Thank you and welcome to ScanSource's earnings conference call for the quarter ended December 31, 2014. With me today are Mike Baur, our CEO, and Charlie Mathis, our CFO. We will review operating results for the quarter and then take your questions. A slide presentation that accompanies our comments and webcast is posted in the Investor Relations section of our website.

Certain statements made on this call will be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from such statements. These risks and uncertainties include, but are not limited to, those factors identified in the release and in ScanSource's SEC filings.

Any forward-looking statements represent our views only as of today and should not be relied upon as representing our views as of any subsequent date. ScanSource undertakes no duty to update any forward-looking statements to actual results or changes in expectations.

We will be discussing both GAAP and non-GAAP results during our call and have provided reconciliations between these amounts in our slide presentation and in our press release. These reconciliations can be found on our website and also have been filed on our Form 8-K. Mike Baur will now begin our discussion with an overview of our results.

Mike Baur - ScanSource, Inc. - CEO

Thanks, Mary, and thank you for joining us today. Let's start with the highlights for second quarter on slide 3 of our deck. I am pleased to report another quarter of record net sales and non-GAAP diluted EPS above our expected range.

Our teams achieved 9% year-over-year net sales growth with very good growth in both of our segments. This growth includes record sales results for our point-of-sale and barcode teams in North America and Europe.

As you know, we manage a portfolio of technology products across North America, Europe and Latin America. For the third quarter in a row our sales mix included a higher volume of big deals which have lower gross margins than our run rate business.



In addition, the significant strengthening of the dollar led to a lower mix of international business compared to our domestic business. As a result the mix of business this quarter, geographic, product and customer mix, led to a 9.7% gross profit margin for the quarter.

Our focus continues to be on growing our businesses with value added margins and providing a platform of services to support that mix of business. This means executing on the strategic investments we discussed last quarter, including our international communication market, physical security, 3D printing, mobile computing and payment terminals. Each of these areas of investment has strong opportunities for growth.

We are pleased to deliver a 14.8% return on invested capital for the quarter and we continue to have a strong balance sheet that positions us for future investments in our business. Recent investments include the completion of two acquisitions to expand our worldwide communications business in Europe and Latin America, both in attractive growth markets with higher-margin opportunities.

On September 19, 2014, we completed our acquisition of Imago Group PLC, Europe's leading value-added video and voice communications distributor. This was our first full quarter with Imago and Imago's first-quarter results were very good.

Earlier this month on January 13, we successfully completed our acquisition of Network1, the largest communications value added distributor in Brazil and throughout Latin America. This acquisition complements our existing successful POS and barcode business in Brazil.

We welcome Rafael Paloni and his team to ScanSource and are now able to offer a full suite of communications, point-of-sale and barcode solutions to this growing market.

With the Network1 acquisition we added nearly 400 employees in additional locations in Brazil, Mexico, Colombia, Chile and Peru. Network1 has over 60 vendors, 8,000 customers and calendar year 2014 estimated sales of approximately \$300 million. Network1 is the largest Company that ScanSource has acquired to date.

We believe these acquisitions are a very good investment and will provide strong bottom-line results to the Company.

With that I will turn the call over to Charlie to discuss our financial results in more detail and our outlook for third quarter fiscal year 2015.

Charlie Mathis - ScanSource, Inc. - CFO

Thanks, Mike. The financial information I will be discussing can be found on slides 4 through 8 of our presentation. As we indicated last quarter, we will discuss our operating results using GAAP and non-GAAP measures. The non-GAAP measures exclude the amortization of intangible assets, the change in fair value of contingent considerations and acquisition costs.

Net sales for the second quarter totaled \$807 million, a 9% increase over the prior year quarter or an 11% increase excluding the impact of foreign exchange from the strengthening of the US dollar. The year-over-year change in foreign currency exchange rates negatively impacted sales by approximately \$16 million with most of the impact in the Worldwide Barcode & Security segment.

Worldwide Barcode & Security sales grew 5% year over year or 8% excluding the impact of foreign exchange. Worldwide Communications & Services sales grew 16%, which includes the acquisition of Imago for the full quarter.

Turning to profitability, as Mike mentioned previously, our mix of business led to a 9.7% gross profit margin for the second quarter 2015. The Worldwide Barcode & Security gross margin decreased to 8.4% from 9% for the year ago quarter, largely due to a higher volume of big deals at lower gross profit margins, timing of vendor program recognition and a lower mix of international business from foreign currency changes.

For Worldwide Communications & Services, the gross margin was 11.8% for the quarter, mainly due to customer and product sales mix. The prior year gross margin of 13.1% was unusually high from timing of vendor program recognition.



Second-quarter 2015 SG&A expenses, excluding acquisition costs and amortization of intangible assets, were \$48.7 million or 6% of net sales versus \$48.4 million or 6.5% of net sales for the second quarter of 2014.

Second-quarter 2015 SG&A expenses included higher employee-related costs driven by additional headcount to support investments in our business. This was partially offset by lower bad debt expense in both of our segments from the reduction of specific reserves and some recoveries.

Our recent acquisitions include earn-out payments as part of the purchase price. Each quarter we re-measure the fair value of estimated future earn-out payments. These fair value adjustments, shown as change in fair value of contingent consideration on the income statement, reflect the time value of the cash flow payments to be paid to the sellers of the acquired Company which is expected to be an expense each quarter.

In addition, these expected fair value adjustments can fluctuate based on changes in assumed discount rate, actual and forecast operating results, foreign-exchange rates and other factors.

In the second quarter of 2015 we recorded a fair value adjustment expense of \$463,000 compared to an expense of \$499,000 in the prior year quarter. Beginning next quarter we expect to have a fair value adjustment expense for the four estimated annual earn-out payments for Network1, which will increase the estimated fair value adjustment starting in the March 2015 quarter.

Given the size of the acquisitions and potential variability of fair value adjustments on operating results, we exclude the change in fair value of contingent considerations from our non-GAAP results including ROIC.

Our second-quarter 2015 non-GAAP operating income was \$29.4 million and a non-GAAP operating margin of 3.6%. On a GAAP basis operating income was \$26 million and an operating margin of 3.2%.

For the Worldwide Barcode & Security segment on slide 5 the non-GAAP operating margin was 2.9% for the second quarter 2015, unchanged from the year ago quarter.

The Worldwide Communications & Services segment on slide 6 the non-GAAP operating margin decreased to 4.9% for second quarter 2015 from 5.6% for the year ago quarter, primarily due to a decrease in gross profit margin partially offset by a reduction in bad debt expense.

Our effective tax rate was 35.1% for the second quarter 2015 and 34.2% for the second quarter 2014. Our effective rate for the second quarter of 2015 increased primarily due to the impact of non-deductible acquisition cost in the current year. We estimate the effective tax rate for fiscal year 2015 at approximately 34% to 35%.

Second-quarter 2015 non-GAAP net income was \$19.7 million or \$0.68 per diluted share compared to \$19.2 million or \$0.67 per diluted share for the second quarter of 2014. On a GAAP basis net income for second quarter 2015 totaled \$16.8 million or \$0.58 per diluted share.

On slide 7 our return on invested capital, which excludes the change in fair value of contingent consideration and acquisition costs, totaled 14.8% for the quarter compared to 16.2% in the prior year and sequential quarter.

Now shifting to the balance sheet and some key metrics. Cash and cash equivalents at December 31, 2014 were \$121.5 million, down from the previous quarter and principally from higher inventory levels.

At December 31, 2014, we had a \$5.4 million of debt, the same as year ago for an industrial development revenue bond for our distribution facility in Mississippi. During the December quarter we had no borrowings from a \$300 million credit facility.

With the acquisition of Network1 in January we assume the net debt as part of the purchase price and expect to have some of the Network1 debt still outstanding as of March 31, 2015.

Days sales outstanding at December 31, 2014 remained at 55 days, in line with our prior quarters. Inventory levels, inventory turns and paid for inventory days, as depicted on slide 8 of our presentation, are within our normal ranges and consistent with our current operating environment.

During the six months ended December 31, 2015, capital expenditures totaled \$13.8 million primarily for our ERP project. We expect total capitalized cost for the ERP project to be approximately \$28 million and to begin depreciating these costs over a 10-year life starting in the March quarter. We plan to go live in Europe, our first go live date, in the March quarter. We remain on schedule and on budget for the project.

As I mentioned in previous quarters, in addition to the capital expenditures and the level of operating expenses we have been incurring over the last year, we expect SAP related ERP expenses in the second half of fiscal year 2015 of \$5 million to \$6 million.

These expenses are primarily for outside services related to SAP implementation costs and training after the first go live that can no longer be capitalized for the project. Again, these costs will not be ongoing expenses for the Company after the North America go live. However, we will have additional SG&A expenses that are incremental to our legacy system of approximately \$1.5 million per quarter beginning this quarter.

We will continue to pursue strategic opportunities to invest in and grow our business including additional acquisitions. We successfully completed our acquisition of Network1 on January 13, 2015 with a cash payment and a fixed amount of assumed debt for an initial purchase price of approximately \$60 million. The Network1 acquisition is structured to include additional annual earn out payments over the next four years.

In August our Board of Directors authorized a three-year \$120 million share repurchase program. We made no purchases during the quarter.

Turning now to our next fiscal quarter and let me add some additional color here. The forecast does include the Network1 acquisition. It assumes continued dollar strengthening and includes the assumption of a go live of our SAP ERP project in the quarter. This includes approximately \$2.1 million or a non-GAAP EPS impact of \$0.05 per share for SAP related ERP costs included in SG&A which will not be ongoing cost to the Company.

We expect net sales for the quarter ended March 31, 2015 to range from \$800 million to \$820 million and non-GAAP diluted earnings per share to range from \$0.54 to \$0.57 per share. I would like to turn the call back over to Mike.

Mike Baur - ScanSource, Inc. - CEO

Thanks, Charlie. We have two reporting segments that we will discuss, so let me start with Worldwide Barcode & Security summarized on slide 9 which represents 62% of overall sales for the quarter. Worldwide Barcode & Security sales of \$500 million increased 5% year-over-year and were up 8% excluding foreign exchange.

Our teams in North America and Europe delivered record sales results. Similar to the last two quarters, it was a strong big deal quarter for our point-of-sale and barcode product lines. Typically big deals have lower gross profit margins and that was the case this quarter.

Our core run rate business remained strong in this quarter and continues to reward us with value added distribution margins. Almost every major product category delivered positive results, including barcode scanning and printing, point-of-sale systems, video surveillance, wireless networking and mobile computing.

We have made investments for this segment in three specific value added growth areas: 3D printing, physical security and payment processing. Each of these areas had significant growth in the quarter and we believe we have the right level of people and services to maximize our opportunities.

Now to our second segment, Worldwide Communications & Services on slide 10, which is 38% of overall sales this quarter. Worldwide Communications & Services' net sales of \$307 million increased 16% from a year ago and increased 17% excluding foreign exchange.

A key element of the growth strategy for this business has been to expand our vendor relationships across other geographies by providing the right set of value added programs and services to our customers. With the completion of the Imago acquisition in late September, we now offer a stronger portfolio of video, voice and data products in Europe.

We have the right vendors, customers and employees necessary to drive profitable growth in this market. The Imago acquisition will accelerate our growth and provide a strong platform for expanding our communications and services presence.

For the first time ScanSource Communications Europe will resemble our successful value-added distribution business in North America. The communications teams had solid year-over-year growth and delivered strong results to the bottom line. Our key investment areas with value added margins are in the ProAV and collaboration markets that demand services and products to be integrated into total solutions by system integrators.

We are starting to roll out new products and services to our customer base including cloud-based voice products that have been developed with our key vendor partners.

With our ScanSource services team we continue to offer value added services to assist our customers' efforts in developing sales leads, streamlining operations, implementation services and project management expertise. These services drive revenue for our product lines and offer a differentiated approach to selling hardware.

During the first half of this fiscal year we had two consecutive record sales quarters and sales growth for both of our segments each quarter. As we move into the second half of fiscal year 2015 we are excited to add the Network1 team to ScanSource and see strong growth opportunities for this business in Brazil and across Latin America. We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Chris McGinnis, Sidoti & Company.

Chris McGinnis - Sidoti & Company - Analyst

I guess just to go through the numbers real quick and the guidance going forward. Charlie, can you walk through the impact of the ERP and maybe what is almost one time in nature? Can you just walk through that again? You went through it quickly and I couldn't get it all on -- and I appreciate it.

Charlie Mathis - ScanSource, Inc. - CFO

Yes, no problem, Chris. Let me do that. And let me kind of walk you through the last quarter results and just say that incrementally we expect to have about a little over \$3 million more SAP related cost in the quarter.

Chris McGinnis - Sidoti & Company - Analyst

That is going forward?

Charlie Mathis - ScanSource, Inc. - CFO

That is for the March ending quarter we expect to have about over \$3 million SAP related costs.

Chris McGinnis - Sidoti & Company - Analyst

And how much of that is one time I guess?



Charlie Mathis - ScanSource, Inc. - CFO

Right, it's that \$2.1 million that I mentioned that is the one-time costs related to SAP services that will no longer be around.

Chris McGinnis - Sidoti & Company - Analyst

Right, I appreciate that. And then I guess just thinking about the margins, where they are at now and how they have compressed. Do you see that similar environment in Q3 as well?

Charlie Mathis - ScanSource, Inc. - CFO

Well, as we mentioned, we see some similarities related to the currency and the mix of the business. But also it is strengthened with the acquisition, Network1. So we really expect the gross profit percentage to be 10% or above.

Chris McGinnis - Sidoti & Company - Analyst

All right. And that doesn't change at all with any of the acquisitions. And is this more of a near-term just because of the larger deals? And then also it sounds like -- could you break out how much of the maybe on a year over year or away from that 10% is currency related?

Charlie Mathis - ScanSource, Inc. - CFO

Yes -- no, it's -- I wouldn't say that a lot of it -- the business we -- we run the business, this value added model that Mike has been talking about to sustain this 10% gross profit margin, which has been consistent for years and years. And that is what we are continuing to do with the different mixes of business that we bring on, different vendors. And so we are pretty confident that we will sustain that model going forward.

Chris McGinnis - Sidoti & Company - Analyst

Great. And I guess maybe just to dig into the business a little bit more. Mike, you mentioned 3D, can you just see --? I know it is very early still and it is still small, but it sounded like you are seeing at least some initial positive. Can you maybe just elaborate on that?

Mike Baur - ScanSource, Inc. - CEO

Yes, sure, Chris. I would say for ScanSource it is not unusual for us to have to devote a considerable amount of time to understand a marketplace. And again, this is one that we did not acquire a way in. So it is a start from ground zero just like we did with our security business in 2004.

As a result what we are learning, we continue to be really not that surprised at, is that the type of reseller that is going to be successful in 3D printing is different from the reseller that is selling security products today and barcode scanning and communications.

So what we are having to do is work with our key vendor partners and really build a channel, a new channel. So it is a channel different than we have today but the similarities with all of our other channels are that these are companies that are trying to sell in a value added model with hardware and software and services and so there is no difference from the business model.

The challenge is identifying the right customer, the right resellers and those who are more likely to be successful. There is already a channel of a few hundred 3D resellers in the US and our job is to help our manufacturers grow those couple hundred beyond.



So what they want us to do in the early days is to find and develop additional resellers to supplement the 200. The plan is that ScanSource will recruit and educate and train. So I would say our strategy so far has been identify the right type of reseller and make sure they then understand the technology.

So we are doing recruiting and then we are doing education and training, because a reseller to get in this business has to invest a significant amount of money in buying a -- for example, they all have to purchase a 3D demo printer to have so that they can produce samples for their customers and demonstrate the product.

So it is a significant financial commitment for the channels we are trying to develop. So I would say those early days of prospecting and then developing are well underway and now we have to help those customers find opportunities to sell. So the selling part of that channel is what we are working on next. That is a lot of detail but that is kind of where we are.

Chris McGinnis - *Sidoti & Company - Analyst*

That's great. And I know you have talked about it recently, just the strength in the retail in the US due to the changes in the chip-and-PIN. Can you maybe just elaborate on that as well?

Mike Baur - *ScanSource, Inc. - CEO*

Yes, we think the marketplace certainly continues to say that there is going to be significant demand. And what really got us excited two years ago was when the point-of-sale traditional reseller was asked by many of these payment processing vendors to start selling the payment terminals.

So we have had significant success with Verifone and Ingenico and that is our traditional reseller customer who was not selling terminals, they are now involved in that process.

And so, the chip-and-PIN and EMV and really it's going to be chip and signature in the US, it's really driving the business towards the retail reseller channel differently than it was a few years ago when it was primarily sold by a separate channel of independent sales organizations that were not selling point-of-sale solutions.

So that is the big change for us, is our existing customer base is starting to sell these products and so that is bringing incremental market share for ScanSource. So we are excited about it, we like it when there are mandates that require retailers to purchase new products. So that is good for our channel.

Chris McGinnis - *Sidoti & Company - Analyst*

Great. And have you seen that pick up in terms of a trend coming at you, I guess the growth rates from that?

Mike Baur - *ScanSource, Inc. - CEO*

We have. So we would say we continue to see strong growth for ScanSource. We are working off of a pretty small base from two years ago, but our customers are seeing significant growth in demand in that space. So, yes, we are seeing success there.

And so we continue to make investments. And for us that means we are adding people which we did over the last couple quarters and capabilities in our distribution center so that we can provide some value to the terminals before they are shipped to the end customer.

There is a process where you have to put a secure code in each one of these terminals before it is installed. And we have added that service capability over the last two years in our distribution center in Mississippi.

Chris McGinnis - *Sidoti & Company - Analyst*

Great. I will turn it over to other people in the queue. Thank you very much.

Operator

Keith Housum, Northcoast.

Keith Housum - *Northcoast Research - Analyst*

Hey, guys, the obvious question here is how much did Imago contribute to the quarter?

Mike Baur - *ScanSource, Inc. - CEO*

Well, Keith, as you know from our past, our practice has been to disclose the trailing 12 months when we make acquisitions. And that is going to be our practice again with Imago and Network1. So we reported trailing 12 of about \$80 million prior to the acquisition.

Keith Housum - *Northcoast Research - Analyst*

Okay, so you are not going to mention what they did for the quarter for you guys. That \$80 million was also before they bought VITEC, correct?

Mike Baur - *ScanSource, Inc. - CEO*

No, that was including VITEC (multiple speakers). And if you remember, the VITEC business was in -- was struggling it was in receivership, so just remember that.

Keith Housum - *Northcoast Research - Analyst*

Got it, got it, okay. And then, Charlie, if I can revisit just the guidance that you and Chris were talking about here. You said \$3 million in the quarter from SAP. That \$2.1 million, is that a part of the \$5 million to \$6 million you guys are talking about for the second half of the year?

Charlie Mathis - *ScanSource, Inc. - CFO*

The \$2.1 million that I talked about is part of the \$5 million to \$6 million I was talking about for the second half of the year.

Keith Housum - *Northcoast Research - Analyst*

Okay, so then for the fourth quarter we could expect then \$3 million to \$4 million approximately, correct?

Charlie Mathis - *ScanSource, Inc. - CFO*

Yes, I would say that that is true based on the timing, yes.



Keith Housum - Northcoast Research - Analyst

And then the other roughly \$1 million to get from the \$2.1 million to the \$3 million, is that the depreciation?

Charlie Mathis - ScanSource, Inc. - CFO

No, that's -- well, that is -- some of that is depreciation in there and some of that is internal resources that we no longer capitalize. So -- and I think -- maybe I need to go back over this and make sure it is clear to you. What I said in here is that our incremental over our legacy business would be about \$1.5 million a quarter going forward.

Keith Housum - Northcoast Research - Analyst

Right. So you have got the \$2.1 million, which is one time, and then we have approximately \$1.5 billion then going forward additional?

Charlie Mathis - ScanSource, Inc. - CFO

Yes.

Keith Housum - Northcoast Research - Analyst

And that includes depreciation?

Charlie Mathis - ScanSource, Inc. - CFO

Yes.

Keith Housum - Northcoast Research - Analyst

So we are really closer to \$3.5 million, \$3.6 million then, correct?

Charlie Mathis - ScanSource, Inc. - CFO

That is correct.

Keith Housum - Northcoast Research - Analyst

Okay, got it. Remind me for the quarter, did you guys have any impact to the bottom line areas as a result of the FX translation?

Charlie Mathis - ScanSource, Inc. - CFO

Yes. As you know, that flows to the bottom line, the FX. So I think we calculated roughly -- to the EPS probably about \$0.01.

Keith Housum - Northcoast Research - Analyst

And what I -- it would be about the same then for next quarter or perhaps even up to \$0.02 with the acquisition of Network1?

Charlie Mathis - *ScanSource, Inc. - CFO*

Yes, we'll probably be more than that, probably around \$0.02 we are thinking.

Keith Housum - *Northcoast Research - Analyst*

Okay, got you. And if you could give a little bit more color in terms of geographically in terms of strength in Europe versus the US. I don't know if I heard as much discussion of that in this script. Just in terms of color of which did better and in which segment?

Mike Baur - *ScanSource, Inc. - CEO*

Yes, Keith, we did not go into more detail. I think our comments were to be more around the technologies rather than about the geography spread. So that was intentional.

Keith Housum - *Northcoast Research - Analyst*

Okay, but would I be correct to assume that Europe is having -- is not growing nearly as fast as North America right now?

Mike Baur - *ScanSource, Inc. - CEO*

Well, my comment was that in barcode we had a strong quarter in Europe, so we did say that. North America and Europe barcode and POS were records.

Keith Housum - *Northcoast Research - Analyst*

Okay. And then the last question for you. In terms of the vendor incentives, I guess how would you guys describe that current market? Is it not as strong because the larger deals are growing better?

Mike Baur - *ScanSource, Inc. - CEO*

Well, I'm trying to think how to explain that. And some of that is proprietary to how we negotiate with our vendor, so I am trying to be careful here. So I would say this is that when you have a -- when you have large deals the -- all of the profitability possible in the deal is up for negotiation. So every program that is offered is also considered on the table when you have larger deals.

Keith Housum - *Northcoast Research - Analyst*

Okay.

Mike Baur - *ScanSource, Inc. - CEO*

Because the vendor and us, we are all trying to work towards a target price and we are willing to work with our margins on those large opportunities, yes.

Keith Housum - Northcoast Research - Analyst

And clearly from your guidance you are expecting a large deal to dominate again next quarter, correct?

Mike Baur - ScanSource, Inc. - CEO

Well, we have got some of that baked in. But as you know, the March quarter, if you just go back historically, it is the most difficult one to forecast only because our vendors always -- they are coming off of their year.

Almost all of our vendors' year end is December, and so it always makes it more difficult to forecast what changes our vendors are going to put on their field people for the March quarter. So I would say it has always been a little more difficult to forecast, that is really all I would say about it.

Keith Housum - Northcoast Research - Analyst

Okay. I will turn it over the queue, thanks.

Operator

Chris Quilty, Raymond James.

Chris Quilty - Raymond James - Analyst

You covered a lot of my questions, but just a follow-up on the investment. You mentioned three areas, the 3D printing, physical security and payment processing. And I think with at least two of the three it looks like it is primarily internal investment and building up those businesses. Are there, however, any opportunities in any of these areas for tuck-in acquisitions per se?

Charlie Mathis - ScanSource, Inc. - CFO

Well, I -- there probably are opportunities. I wouldn't comment on our strategy of what we are specifically targeting. But we are always looking to fill gaps in our strategy whether it is geographically or product wise. But that is about as far as I would go, Chris, on that.

Chris Quilty - Raymond James - Analyst

Okay. And, Charlie, just as a follow-up can you remind us the -- with regard to foreign-exchange in Europe specifically, sales in local currency US dollar and hedging strategies?

Charlie Mathis - ScanSource, Inc. - CFO

Yes. So the impact for the quarter, the product was about \$16 million. That all flows to the bottom line. As we said, it was about a \$0.01 per share impact there. And we do hedging there, but it is really on the balance sheet that we are doing hedging. So that's really the story there.

Chris Quilty - Raymond James - Analyst

And does it -- sales in US dollar or local currency by country or for the region?



Charlie Mathis - ScanSource, Inc. - CFO

Mostly in the currency, the local currency.

Chris Quilty - Raymond James - Analyst

Okay. So you wouldn't expect local resellers -- distributors, excuse me, to have any kind of a specific competitive advantage based upon foreign-exchange?

Charlie Mathis - ScanSource, Inc. - CFO

No.

Chris Quilty - Raymond James - Analyst

Okay. That is it for me. Thank you, gentlemen.

Operator

(Operator Instructions). Andrew Spinola, Wells Fargo.

Andrew Spinola - Wells Fargo - Analyst

I'm going to try the gross margins just one more time in my way hopefully. The Barcode & Security it sounds like is a little bit lower because of the large deals. And the Communication & Services gross margin is down a little bit year over year because last year was unusually strong. Is that -- and your sort of longer-term way to think about gross margins remains 10% for the business. Is that what I hear you saying?

Mike Baur - ScanSource, Inc. - CEO

Yes, that is what you heard.

Andrew Spinola - Wells Fargo - Analyst

Perfect. And then when I am thinking about operating margin it sounds like the ERP is coming with an additional -- sort of after the one-time expenses for the go live there are some additional resources that will no longer be capitalized and will be running through SG&A at I think \$1.5 million a quarter, is that what you were saying.

Mike Baur - ScanSource, Inc. - CEO

Yes, that is correct.

Andrew Spinola - Wells Fargo - Analyst

So I guess -- so the way -- what I am trying to figure out when I'm thinking about my model for fiscal 2016 and beyond is does this ERP system generate savings on the gross margin line or is there any sort of offset or is it truly an additional \$6 million on the SG&A line and margins are just permanently a little bit lower by that \$6 million?

Charlie Mathis - ScanSource, Inc. - CFO

Well, I would say that for us that -- we have a platform for growth and our goal is to be able to grow out of this additional cost. And we think we will. We think we will be able to grow out of this in a reasonable timeframe. We have not factored in the efficiency cost savings from the SAP Project.

Andrew Spinola - Wells Fargo - Analyst

Got it. So you -- so it is fair to think that there will probably be some SG&A leverage in the years to come?

Charlie Mathis - ScanSource, Inc. - CFO

Yes.

Mike Baur - ScanSource, Inc. - CEO

Yes and I would add one comment, Andrew, is that today we operate in these multiple geographies with about six different IT systems. And so it is fair to say that we could be more efficient and there are some other ways that we can utilize a single system to facilitate additional growth such as acquisitions and that is something that we decided a long time ago we needed to move to.

So this has been a long time planning, as you know. And we do believe though that we wouldn't have made this decision if we didn't believe we could grow through this expense over time.

Andrew Spinola - Wells Fargo - Analyst

Got it, that makes a lot of sense. Just a last one for me. I am sure we have us this in previous calls, but the more big deals in the barcode POS business, is that a structural change or a cyclical change you think? And maybe any just reasoning around that that you could help us understand would be great.

Mike Baur - ScanSource, Inc. - CEO

Yes, so we have had -- for a couple quarters in a row we have had this go on. If you go back and just look over years, it was very common always in the December quarter for our point-of-sale business to have big deals. And so, we saw that and it was a good sign that some of our larger customers who deal with larger retailers -- and some of the barcode customers as well. But it was more of a retail phenomenon, we saw products sold, systems replaced.

And so we believe -- and this was primarily a North America phenomenon -- that it was a sign that there is some replacement going on in the retail space and our customers took advantage of that. And it is typical for it to happen in the December quarter even though most people would think retailers are busy, well that is generally when they buy because they want to negotiate incentives in that quarter.

Andrew Spinola - Wells Fargo - Analyst

Got it. And actually one more for me. If I just sort of assume Imago was \$20 million in the quarter, the international business was -- didn't grow as strongly as the US and you made that comment about Europe being pretty solid in barcode. Is there any reason that -- or is there any sort of pronounced weakness in markets outside the US and Europe that might be a concern from a macro perspective?



Mike Baur - *ScanSource, Inc. - CEO*

Well, don't forget the \$16 million on the translation of the currency, right, because that is a big part of it. So if you didn't have that going on I would say, no, it is pretty normal. Pretty normal balance of business across the markets.

Andrew Spinola - *Wells Fargo - Analyst*

Got it. All right, great. Thank you very much.

Operator

And I am not showing any further questions at this time. I would like to turn the call back over to management for closing remarks.

Mike Baur - *ScanSource, Inc. - CEO*

Great, thanks for joining us today. We expect to hold our next conference call to discuss March 31 quarterly earnings results on April 30, 2015.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a good day.

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