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SCSC - Q4 2014 ScanSource Inc Earnings Call

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PRESENTATION

Operator

Welcome to the ScanSource quarterly and year-end earnings announcement conference call.

(Operator Instructions).

I would now like to turn the call over to Mary Gentry, Treasurer and Director of Investor Relations. Ma'am, you may begin.

Mary Gentry - *ScanSource, Inc. - Treasurer & Director of IR*

Thank you and welcome to ScanSource's earnings conference call for the quarter and year ended June 30, 2014. With me today are Mike Baur, our CEO and Charlie Mathis, our CFO. We will review operating results for the quarter and year 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 press release which can be found on our website and also filed with our form 8K. 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 the fourth quarter on slide 3. We reported fourth quarter 2014 net sales of $758 million and adjusted EPS of $0.60, both above our expected range. We had diluted EPS of $0.94 including a $15.5 million legal recovery related to our previously disclosed ERP litigation. Charlie will go into more detail on the numbers in a minute.

Our worldwide barcode and security segment had record net sales for the quarter and for the year. Fourth quarter sales increased 10% year-over-year with record sales for our North American POS and barcode and security business unit driven by big deals. In addition, we had another solid quarter for sales growth for Brazil and Europe.

For worldwide communications and services, net sales rebounded from the March quarter with 18% sequential quarter growth including growth for each business unit. ScanSource communications in North America had a record sales quarter and as expected, our worldwide communications and services sales were unchanged from the prior year quarter. We ended fiscal year 2014 with 6% net sales growth for the fourth quarter returning to growth after three quarters of no growth.

For the full year, net sales increased 1% to $2.9 billion while adjusted operating income increased 4% with higher gross and operating profit margins. This reflects better operating results for our international business than a year ago including improved performance for Europe and Brazil. Now turning to slides 4 and 5. Last week we announced an agreement to acquire Network1, Brazil's leading value added communications distributor.

We had been looking for the right opportunity to expand our successful growth business in Brazil with the addition of communications products in that geography. Network1 does that. We are excited about this opportunity and that Network1's CEO, Rafael Paloni will lead ScanSource's communication business in Brazil and the rest of Latin America. This fits with our strategic goal of becoming a leading value-added distributor of communication solutions in Latin America.

For both ScanSource and Network1, business will continue as usual during the due diligence period as we work toward a 2014 calendar year closing. Summarized on slides 6 and 7, today we announced the execution of a letter of intent to acquire Imago, Europe's leading value-added video and voice communications distributor. This proposed acquisition continues our strategy of focused growth in international markets in the communications business.

With over 20 years of experience and a proven track record of success, Imago will be a strong addition to our European communications strategy. We are excited about adding Ian Vickerage, Imago's managing director and founder to our management team to continue to lead the company. We expect to close this acquisition by the end of September. Both Network1 and Imago have demonstrated double digit sales growth and operating margins consistent with ScanSource's communications business.

We expect the acquisitions to be accretive to EPS and ROIC in the first year, excluding acquisition costs. On slide 8 we summarize how these acquisitions are expected to shift our sales mix to more international, which would be [34%] (corrected by company after the call) of a fiscal year 2014 sales pro forma and more communications mix, which would be 43% of fiscal year 2014 sales pro forma, both key strategic growth initiatives for ScanSource. With that, I'll turn the call over to Charlie to discuss our financial results in more detail and our outlook for first quarter fiscal year 2015.

Charlie Mathis - *ScanSource, Inc. - CFO*

Thanks, Mike. The financial information I will be discussing can be found on slides 9 through 17 of our presentation. I'll discuss our fourth quarter and full year 2014 results and then give our consolidated first quarter 2015 forecast. Let me begin with revenue. Fourth quarter consolidated net sales of $758 million increased 6.4% from $713 million for the prior year quarter.

Worldwide barcode and security sales increased 10% year-over-year, a record sales quarter as previously mentioned, while worldwide communications and services sales were relatively flat. For the full year, consolidated net sales increased 1.3% to $2.9 billion with a 2.5% increase for worldwide barcode and security. Our Brazil business unit grew the fastest at approximately 9% or 22% in local currency for the full year.

Sales for worldwide communications and services declined 0.8% for the year, although ScanSource communications in North America, which includes our Polycom business had record sales. Turning to profitability, the consolidated gross profit margin for the fourth quarter 2014 was 9.8%, down from 10.6% in the prior year quarter primarily due to product mix, higher big deals and favorable adjustments for European operations in the prior year.

If you recall, this time last year I stated that gross margins were higher than expected and one of the reasons was due to the favorable resolution in Europe of several inventory aging issues and certain adjustments related to timing of vendor programs. For the full year, consolidated gross margins were 10.3% for 2014 compared to 10.2% for 2013.

The worldwide barcode and security gross margin decreased to 8.5% from 9.7% for the year ago quarter, largely due to increased big deals, favorable adjustments in the prior year for Europe that I just mentioned that did not recur and a less favorable sales mix in our security business unit. For the full year, our worldwide barcode distributor segment reported gross margins of 9% for 2014 compared to 9.2% for 2013.

For worldwide communications and services, the gross margin remained flat at 12% for the quarter, primarily due to higher net services revenue fees and favorable sales mix for North America business units, offset by European's favorable adjustments in the prior year that did not recur. For the full year, our worldwide communications and services segment reported gross margins of 12.8% for 2014, an increase from 11.9% for 2013, primarily from higher service fee income and improved vendor program attainment.

Now moving to SG&A expenses, which included some one time items this quarter as well as prior year quarter of $15.5 in million legal recovery in fourth quarter 2014 and a $48.8 million in non-cash impairment charges in the fourth quarter of 2013. Excluding these one time items, SG&A expenses totaled 6.5% of net sales for fourth quarter 2014 and 6.6% of net sales for fourth quarter 2013.

We continue to focus on effectively controlling our operating expenses, which includes bad debt expense, while at the same time investing in our people and infrastructure for our future growth. For the full year, excluding the one time items, SG&A expenses increased 1.8% for the fiscal year 2014 versus fiscal year 2013. This was largely a result of increased headcount and higher healthcare costs offset by lower bad debt expense from improved aging and recoveries.

Each quarter we re-measure the fair value of our earn-out for CDC Brazil acquisition for fair value. For fourth quarter 2014 we recorded fair value adjustment loss of $100,000 compared to a loss of $400,000 in the prior year quarter. Going forward we would expect the fair value adjustment for CDC Brazil each quarter of fiscal year 2015 of approximately $500,000. This could fluctuate based on assumed discount rate, actual operating results and other factors.

The final earn out payment for CDC Brazil is planned within the fiscal year 2015. Going forward, both of our planned acquisitions are structured with earn out payments. We believe this earn out structure has served us well in Brazil over the last four years and best aligns the buyer and seller on ensuring the greatest future performance with shared risk.

Earn outs represent 48% of the purchase price of the Network1 agreement and 10% of the proposed purchase price for Imago. At closing we will record a contingent consideration for the present value of these expected payments and we will have quarterly fair value adjustments. Fourth quarter 2014 consolidated non-GAAP adjusted operating income and consolidated adjusted operating margins declined from the prior year quarter, primarily from the decrease in gross margins previously discussed.

For the full year, excluding the one time items, non-GAAP adjusted operating income increased 4% to $106.3 million, resulting in a 3.65% adjusted operating margin primarily from higher gross profit margins. Our effective tax rate was 33.7% for the fourth quarter 2014 and 33.6% for fiscal year 2014. We expect the effective tax rate for fiscal year 2015 to range between 33% and 34%.

Excluding the one time items previously discussed, fourth quarter 2014 non-GAAP adjusted net income was $17.3 million or $0.60 per diluted share compared to $19.9 million or $0.71 per diluted share for fourth quarter 2013. On a GAAP basis, net income for the fourth quarter 2014 totaled $27.1 million or $0.94 per diluted share. For the full year 2014, non-GAAP adjusted net income totaled $72 million or $2.52 per diluted share, an increase from $69.3 million or $2.47 per diluted share for fiscal year 2013.

On a GAAP basis, net income for fiscal year 2014 totaled $81.8 million or $2.86 per diluted share. Our return on invested capital totaled 13.9% for the quarter compared to 17.2% and 14.8% in the prior year and sequential quarter respectively. For the full year, return on investment capital totaled 15.4% for 2014 compared to 16% for 2013, adjusted for one time items. Now let me discuss the balance sheet and some key metrics. Cash and cash equivalents in June 30, 2014 were $194.9 million, up $11.3 million from the end of March.

Accounts payable includes checks released but not yet cleared. Uncleared checks totaled $84.2 million at the end of June, up from $53.2 million at the end of March related to the timing of vendor payments. For the trailing 12 month period, we generated $48 million in cash from operating activities. Days sales outstanding at June 30, 2014 remained at 55 days, in line with our prior quarters.

Inventory returns of 5.6 times for the quarter improved from 5.1 for the March quarter, but slowed from 6.2 times for the prior year. Inventory levels increased $102 million from the year ago level, as we have adjusted our business for our returns and sales growth. Paid for inventory days at the end of June 2014 increased to 10.9 days, down from 15.3 at the end of March and up from 5.7 days for the end of prior year at June quarter.

At June 30, 2014 we had $5 million of debt, the same as a year ago, for an industrial development revenue bond for a distribution facility in Mississippi. During the last year we had no borrowings from our $300 million credit facility. In January we kicked off our new ERP project with the SAP and recently came out of our critical blueprinting milestone. We are on schedule and on budget.

Early in the fourth quarter, Blake Zemp joined ScanSource as our new Chief Information Officer. Blake brings 30 years of experience from global information system leadership roles at Milliken & Company, and extensive SAP implementation experience for the supply chain on the global basis. We are very pleased to have Blake in this important role for ScanSource. During the quarter, we settled our ERP litigation related to Microsoft Dynamics AX project which we impaired a year ago and received a $15.5 million net legal recovery.

During fiscal year 2014, capital expenditures totaled $13 million, primarily for our ERP project. For the fiscal year 2015 we expect total capital expenditures to be $17 million to $22 million, primarily for our ERP project. We plan to go live in Europe, our first go live date, during the second half of fiscal year 2015. In addition to the capital expenditures and the level of operating expenses we have been incurring over the last six months, we expect additional one time SAP related ERP expenses in the second half of fiscal year 2015 of $5 million to $6 million.

These expenses are for 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 costs for the company. We believe we have significant resources and capital to grow the company in the future while maintaining our high margins and high ROIC. Our capital allocation priorities include investing in organic growth for our businesses around the world and acquisitions that meet our strategic and financial goals.

Our planned acquisition of Network1, which we expect to close at the end of calendar year 2014, is structured with initial payment price of BRL160 million or approximately $71 million plus earn out payments over the next four years. Our proposed acquisition of Imago, which we expect to close by the end of September 2014, is structured with an initial purchase price of approximately GBP24.5 million or approximately $41 million plus earn out payments over the next two years.

We expect to fund these acquisitions from our cash on hand. We will continue to pursue strategic opportunities to invest and grow our business including additional acquisitions. Today we're announcing a $120 million three year share repurchase authorization. Depending on market conditions, we may repurchase shares under this authorization and let me emphasize the word may, as this will be a very disciplined approach, principally used to offset dilution from stock compensation plans.

Turning now to our next fiscal quarter. Excluding acquisitions and acquisition costs, we expect net sales for the quarter ended September 30, 2014 to range from $750 million to $770 million and earnings per share to range from $0.59 to $0.61 per diluted share. With that, I'll turn the call back over to Mike.

Mike Baur - *ScanSource, Inc. - CEO*

Thank you, Charlie. Let me start with our worldwide barcode and security summarized on slide 18, which represents 65% of overall sales for the quarter. Worldwide barcode and security sales of $491 million increased 10% year over year and 8% sequentially. Building on last quarter's growth, we had a record sales quarter for this segment with year-over-year increases for all geographies except our Miami export business.

It was a strong, big deal quarter in our business with each of our top 10 vendors grew year-over-year. Our POS and barcode unit in North America had a record sales quarter driven by big deals in POS and strong run rate business in our AIDC mobility barcode business. Sales across all product categories: mobile computing, POS, scanning and barcode printing increased both year-over-year and quarter-over-quarter.

We believe that the Windows XP end of life upgrade cycle contributed to our POS growth as many retailers had to upgrade older POS systems. Our barcode business picked up also this quarter as we regained some market share from competition. The POS payments terminal hardware business grew double digits as we gained share.

We have recently partnered with Ingenico and FreedomPay to sell configured hardware and key injections services for the first PCI certified encryption and EMV payment solution in North America, all part of getting ready for the upcoming shift to EMV enabled payment platforms. Our business continues to improve for our POS and barcode team in Europe with good year-over-year sales growth for the second quarter in a row.

This includes upper single digit growth for each of our top three countries: the United Kingdom, Germany and France. We had big growth with scanners and mobile computing. During the quarter we added a new vendor as we launched Motion Computing's rugged tablet solutions for retail, healthcare and other vertical markets in the UK and Benelux countries. Our security business in the US and Canada had a record quarter with its highest quarter ever for big deals including record quarters with our top networking vendors.

The June quarter is seasonally strong for big deals from our education business. By product category, strength in networking and access control products offset lower video surveillance camera sales where market growth had slowed in some areas. We had a good sales quarter from two of our newer vendors, Pivot3 with their software defined storage products for video surveillance and Speco video camera surveillance solutions.

Just a few comments on 3-D printing, our newest technology business unit that we launched last quarter. The overall 3-D printing market continues to receive a huge amount of buzz as new applications and solutions continue to be introduced by the manufacturers and channel partners. Our focus right now is on reseller recruitment and reseller enablement with the 3-D systems channel to a variety of business development activities.

We are holding recruitment events, developing content for vertical markets and organizing webinars to introduce the technology to our existing ScanSource VARs. As we recruit new channel partners, we are working to enable their early success by providing technical and sales training and doing end-user lead generation activities. We're still in the early stages for two-tier distribution, but we believe we are investing for the long term in a value added business.

For the fourth quarter sales in Brazil increased 8% year-over-year or 17% in local currency with excellent growth across all product categories. We continue to pick up market share as well from smaller competitors because of our inventory availability and our financial strength which is winning new business for our team. We're also benefiting from a technology shift associated with new fiscal printer legislation that has driven solid growth in our printer sales results.

We are also seeing some good results with Datalogic, a new vendor for us in Brazil. In Mexico sales were up 8% year-over-year driven by a return to large deals. Worldwide communications and services on slide 19 is 35% of our overall sales this past quarter. Worldwide communications and services' net sales of $268 million were unchanged from a year ago, but increased a strong 18% sequentially.

As expected, sales rebounded from last quarter, with quarter-over-quarter increases for all the business units. Across the communication business units, we had strong performance from networking vendors and it was also a good sales quarter for vendor service contracts including better contract renewals. ScanSource communications in North America had a record sales quarter led by record quarters for several of our vendors.

We still see a lot of opportunity for shifting business from a one-tier model to a two-tier model from some of our key vendors here. ScanSource catalyst hit its sales forecast for the quarter with strong sales in networking, wireless and services. In North America we expended our distribution relationship with Extreme Networks and began distribution of Enterasys products. In May our two North American communication business units held a successful joint partner conference named 1Comm to promote partnering opportunities.

We are bringing our ScanSource Catalyst best practices in North America to our Europe team so we can deliver more value to our channel there. These proven tools and processes will allow our team to more easily recruit partners and drive incremental revenue. ScanSource Services Group had a good quarter for professional service offerings which include Wi-Fi services, network assessments, voice and video implementation and cloud services.

We continue to expand our configuration services with a record number of IP, phone, provisioning units this quarter and increases in key injections for the POS payment terminal business.

We had a strong finish to our fiscal year 2014, exceeding our expectations for sales and profitability.

We returned to sales growth and are excited as we look ahead to the opportunities in 2015. We are very pleased with the proposed acquisitions that we discussed today and this week and our planned value added growth in international markets in the communications segment. With that, we will turn it over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Chris McGinnis, Sidoti & Company.

Chris McGinnis - *Sidoti & Company - Analyst*

Just a quick question on the Network1, can you talk a little bit of how your position and maybe the experience of already being in there in the acquisitions from CDC, how that benefits you going forward for the Network1 acquisition?

Mike Baur - *ScanSource, Inc. - CEO*

Chris, this is Mike. The basic premise here is this brings us new products that we're not selling currently in Brazil, so we've acquired a leading company that's working with key vendors. Many of them we're already working with in other geographies like Avaya and Polycom. So we are excited that we are able to partner with these guys.

They have already proven their success for several years in Brazil and we were looking at doing it ourselves which, we talked about over the last couple of years. We talked about how do we take our CDC Brazil team and add the communication products and vendors to them. We looked at that and instead decided to go and acquire the expertise because we didn't think we could get there fast enough on our own.

Frankly, our team in Brazil today, the CDC team, is doing a fantastic job of growing the business in barcode and POS and we didn't want to miss the opportunity to go ahead and get into that business and we felt like Network1 had the right team. Rafael and his management team are excited about this opportunity. Their vendors are also excited about the partnership because ScanSource can bring the financial resources that these guys will need to continue growing at the pace they have.

Chris McGinnis - *Sidoti & Company - Analyst*

Just to follow-up on that, can you talk about the competitive landscape in the region? Can you talk a little bit about the dynamics of where Network1 fits into the competitive landscape there?

Mike Baur - *ScanSource, Inc. - CEO*

In Brazil there are some smaller players and then there are some of the traditional broad-line distributors that we see in other markets. We've got both types of competitors there, but as we have learned in the market, starting in North America and then as we grew into Europe, we believe that the real specialty value added model still is preferred by the vendors and the resellers.

It's true in Brazil just like it was in the US and Europe, is that a very focused team that's not trying to chase broad-line revenue is better, it's a way for us to focus, to deliver value added services. Frankly, the margin opportunity, the gross margin opportunity and the operating margin opportunity here is very strong for us. These guys have carved out the leading position, even competing with some of the same big distributors that we have in our other markets.

Chris McGinnis - *Sidoti & Company - Analyst*

Two quick questions: one is, you talked about gaining share in the POS market, could you talk about what is driving that? Is it a change in the way you're going to business? Is it the increase in sales force or can you talk a little bit about how you are gaining that share back?

Mike Baur - *ScanSource, Inc. - CEO*

I think part of it was we felt like we weren't aggressive enough in some of our markets, so we were letting some business go away from us and we decided that it was a better business decision for ScanSource if we took back some of that market share. Some of that you saw in our margins, that our margins are somewhat lower for the fourth quarter.

That was because of big deals which also came back and some of those big deals were because we were more aggressive in going after the business. That was a North America story primarily, although some of that also happened in Europe. I would say in North America, where we've been the longest in our business, we decided to be more aggressive in the marketplace against competition.

Chris McGinnis - *Sidoti & Company - Analyst*

Lastly, you mentioned the benefit from the Microsoft re-do, how long do you expect that to linger in the market in terms of a positive benefit?

Mike Baur - *ScanSource, Inc. - CEO*

Kind of hard to say. I think the whole IT industry saw some benefit and retailers were no exception. XP became a standard operating system maybe 10 or 12 years ago, so our larger POS systems business -- think our Toshiba business, our NCR business, those are the kind of products that really saw the success where it's more the medium to larger retailers that had traditionally used those products.

These are the systems that were replaced and some of the big deals we referenced earlier, they came out of our POS business in North America. So, hard to say right now. Our forecast for next quarter suggests still a good North American business in that area, but we'll just have to see how that plays out.

Chris McGinnis - *Sidoti & Company - Analyst*

One last quick one on the share repurchase program. Charlie, did you repurchase any shares in the quarter or after the quarter or any?

Charlie Mathis - *ScanSource, Inc. - CFO*

No, we have not.

Operator

Ryan Rackley, Raymond James.

Ryan Rackley - *Raymond James - Analyst*

Can you talk about your gross margin profile for 2015 as far as what you see with big deals and product mix going into the year?

Charlie Mathis - *ScanSource, Inc. - CFO*

Chris, this is Charlie. On the gross margins, we expect the gross margins to be up from this prior quarter. We've been talking about 10% gross margins for some time, that's where we'd be comfortable with going into the quarter.

Ryan Rackley - *Raymond James - Analyst*

Actually, this is Ryan. I appreciate the EBIT margin on the two acquisitions, can you give any guidance on how the acquisitions are going to impact you guys at the gross margin line?

Mike Baur - *ScanSource, Inc. - CEO*

One comment I will make, Ryan is that these are our communication type businesses so there will be, typically our communication business, as you recall, is higher gross margins because there's more value added services. Generally speaking, those markets require more SG&A from us as well. So generally, the communications businesses, and both of these are, will have higher gross margins, yes.

Ryan Rackley - *Raymond James - Analyst*

Finally, can you talk about potential scenarios or what could happen if Symbol gets through with acquiring Zebra, what effect that could have on your business?

Mike Baur - *ScanSource, Inc. - CEO*

The Zebra acquisition of the old Symbol business from Motorola is something that we have certainly spent a lot of time talking to them about. We don't anticipate a change. I would say they are making sure, they being the Zebra guys and the Motorola guys, both companies management teams are making sure there is really no change. What we have been told and what we believe, is that they want the business right now and post close to be the same as it is.

We are and will still be their largest distributor worldwide. So we believe they are excited about their opportunity together, but that they need to have the execution in the channel, not miss a beat. I think that is what our teams are focused on and their teams in the field are as well. We think it's business as usual and we haven't seen any reason to doubt that.

Operator

Keith Housum, Northcoast research.

Keith Housum - *Northcoast Research - Analyst*

Charlie, this is first question for you, inventory and accounts receivable is up quite a bit this year over last year with inventory being up $100 million. I got from the script that you guys were preparing for growth, but 25% increase year-over-year seems like there's quite a bit in there. Can you provide a little commentary on your thoughts on the inventory position now.

Charlie Mathis - *ScanSource, Inc. - CFO*

I would say that last year inventory levels were very low, reflecting maybe the optimism going into the year. I think we are comfortable with the inventory levels currently, based on the amount of demand that we see and growth opportunities. It's within our range of inventory turns, so I think we're pretty comfortable with the levels there and maybe last year was just lower than we would have expected or would have been usual for the company.

Keith Housum - *Northcoast Research - Analyst*

How about with accounts receivable, there was about 15.9, almost a full point over last year in terms of sales per year. Are you guys satisfied with those levels?

Charlie Mathis - *ScanSource, Inc. - CFO*

Probably the sales in the quarter being higher than last year, our DSO is pretty much 55 days and it has been, so I think that's pretty normal as far as the accounts receivable goes.

Keith Housum - *Northcoast Research - Analyst*

With the two acquisitions that you guys have pending, is there going to be a need to beef up their balance sheets and beef up their working capital or are you guys satisfied with their levels as you anticipate them to be?

Charlie Mathis - *ScanSource, Inc. - CFO*

Yes, these have earn out structures on both of them, so both the ideas that they would be run independently. They manage the balance sheet very well. Both companies focus on working capital. So we're going in with the idea that they have an adequate level of working capital on the balance sheet and hopefully growth going forward, we can help them get them there with any type of funding needs they would have.

Mike Baur - *ScanSource, Inc. - CEO*

One other thing would be in Brazil, we would have a lower cost of borrowing than those guys, so they will benefit from some of that, I think.

Keith Housum - *Northcoast Research - Analyst*

In Brazil you guys still need to borrow?

Charlie Mathis - *ScanSource, Inc. - CFO*

Sometimes we do if we need to because maybe the cost of capital is less, depending on what treasury decides they want to do. We don't need to borrow anywhere, as you see with our cash balances. We expect these to generate cash and an excellent return on our IRR going forward, so we're really excited about these and look to get them closed within the next six months.

Keith Housum - *Northcoast Research - Analyst*

Mike, you said you guys had a strong finish to the quarter. Did that strong sales carry over to the beginning part of this quarter?

Mike Baur - *ScanSource, Inc. - CEO*

I would say this, and this is the quarter every year where we're giving a forecast that, where we're already well into the quarter. So sitting here 21st day of August, we feel very good about our forecast and we have the ability to because July has already happened and we know where those sales are and we know what August is trending. I would say this forecast that we're giving at the midpoint, we think is very consistent with a typical September growth over June and so I don't see anything that would cause me concern. We feel very good about the forecast.

Keith Housum - *Northcoast Research - Analyst*

If I could come back to the share repurchase, Charlie, I think I heard you say that there might be a preference there to offset the dilution that you guys are seeing as opposed to being actively involved in buying back share. Is that a correct understanding?

Charlie Mathis - *ScanSource, Inc. - CFO*

Yes, that would be a correct understanding. Even in that situation it would depend on the market conditions that we're in, but that is principally the reason.

Keith Housum - *Northcoast Research - Analyst*

In terms of the capital allocation strategy, it sounds like acquisitions are still the preferred method of using the capital?

Charlie Mathis - *ScanSource, Inc. - CFO*

Absolutely and that's how the company has done it throughout its 20 year history and that's the way we look to do it going forward.

Keith Housum - *Northcoast Research - Analyst*

With these two pending acquisitions, does this take you guys to the sidelines for a while? Or are you guys still going to be involved if the acquisition opportunities appear?

Charlie Mathis - *ScanSource, Inc. - CFO*

No, we will continue to look for acquisitions even after announcing these. We're continuing to look for additional acquisitions that would make sense strategically and financially, as we believe these have.

Keith Housum - *Northcoast Research - Analyst*

Final question for me on Imago, the latest acquisition you announced today. It appears Polycom is probably the lead vendor there that I am personally familiar with. Does this give you guys the relationships that perhaps have been lacking with those guys and others in that local market?

Mike Baur - *ScanSource, Inc. - CEO*

Sorry, I didn't follow that part, Keith about the relationships, say it again?

Keith Housum - *Northcoast Research - Analyst*

It looks like Polycom is probably the lead vendor for Imago and if my research serves me correct, that's probably one of the relationships you guys have had a tough time with in Europe. Does this solidify your opportunity with Polycom there and give you the relationships you've perhaps been missing?

Mike Baur - *ScanSource, Inc. - CEO*

I understand better now, thanks. We did not do well trying to come out with a Polycom strategy a couple years ago. When we really go back and look at the acquisitions we made in Europe, if you think back with us, the acquisition we made in England which was MTV Telecom, that was really an Avaya-SMB voice-centric acquisition. When we go back to the Algol in Germany, their expertise was really data.

They were strong with data and some voice and we really didn't have in either one of those, a strong video platform. We've learned, even back to 2006 when we bought T2, our successful acquisition in North America where we had a Polycom relationship, we still weren't the lead distributor for video. We learned that we had to really get some specific expertise or help in that market to complement our voice knowledge and that's probably what we thought we could get away with a couple years ago in Europe.

The reality is, the video expertise is still very, very important to have. Day one, customers want to know that you have the people on staff that know the products. The vendors really want to trust you, but they don't want to see someone, totally a start up and they believe that the video expertise is different and unique from data expertise and voice.

Now, we've kind of got all three areas of focus for our communication business covered by bringing Imago in and we think this will complement what we have already in our German, formerly Algal business and our MTV business, formally in the UK. This is the missing piece that we really lacked to want to make our European communication business come together.

I think Polycom knew that. They really had talked to us, even a couple years ago, about what you guys need, Mike, is you really need a strong platform and I met Ian probably six years ago. They've been a company we've had a lot of respect for and that we really saw that their business was so much like ours, that it made a lot of sense if we could work out the deal correctly. We're thrilled to have Imago as part of our planned acquisition there.

Keith Housum - *Northcoast Research - Analyst*

One follow up if I may, both Network1 and Imago appear to be growing by double digit sales growth. Is that market growth or are they taking share? How are they accomplishing that?

Mike Baur - *ScanSource, Inc. - CEO*

In one aspect, both of them have not grown out their opportunity in their geographies. So for example, staying with Imago, they're not in every country today with Polycom. I think the number of distributors for Polycom worldwide is 120. So, it is our belief that many of those smaller distributors probably can't expand beyond their local markets and in some areas that will always be the case.

But there is an opportunity to consolidate some revenue in Europe and we believe that Imago can continue to grow by moving into other countries. In Brazil, what they have been able to do is take some of their vendors and they've added more without competing with their existing line card. So they've got more vendors in Brazil than Imago has in Europe and that ScanSource has even in the US. I think in Network1's case, they're building out their vendor portfolio across Brazil.

Operator

Chris Quilty, Raymond James.

Chris Quilty - *Raymond James - Analyst*

If I recall, in the last conference call you had talked about a potential acquisition that might add a fourth leg in terms of the product assortment and at least in these two acquisitions, that doesn't seem to be there, so is it fair to assume you've still got some stuff in the pipeline?

Mike Baur - *ScanSource, Inc. - CEO*

Yes. I would love to figure out -- let me just go back. In security, at the technology unit that was our third leg that we have not made an acquisition in, we have looked in that market for targets and we still would be interested if we could find the right fit. In 3-D printing, similarly, there is probably not an obvious target, but we believe there might be an opportunity to still go after some aspect of the 3-D business and take that business to another, maybe takes a different level.

It may be that we don't buy a traditional technology distributor, but maybe a complementary partner. If you remember back in the early days of ScanSource barcode in the 1990s, we started a business down in Atlanta and we acquired a company called OUI. They gave us some services expertise which helped us accelerate the Avaya business and I could see us trying to find maybe a services company even in one of those markets. Those are the kind of ideas we've got where they don't have to be traditional two-step distributors that we are trying to acquire.

Chris Quilty - *Raymond James - Analyst*

With both of these acquisitions, were they negotiated deals or auctions?

Mike Baur - *ScanSource, Inc. - CEO*

Well, I'm not sure I want to say. We've got a history of acquisitions and we have a strategy and we try not to publish that too much.

Chris Quilty - *Raymond James - Analyst*

Can you talk about any type of synergies in terms of warehouse consolidation that you might be able to achieve?

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Mike Baur - *ScanSource, Inc. - CEO*

For us, that would be the last thing we need to do to make these deals work. For us, the synergies that we might could get from that are not most important to us. Our belief is we've got -- both of these of these companies are high-growth companies at strong margins. So our objective will be to get out of their way at first and let them continue to grow their markets.

Of course, if it makes sense where we can get some synergies in the back office, we'll look at it, but that is not the most important thing we've got on our plate. We structured the earn outs traditionally. We did the same with CDC where we let that management team decide when that's better for them is to have access to some of our shared services. We're going to certainly do the right thing from a financial controls and all that, but I don't think any warehouse sharing would be necessary to make these a success.

Chris Quilty - *Raymond James - Analyst*

Charlie, can you talk about where you're comfortable in terms of debt to EBITDA or other leverage ratios you focus on?

Charlie Mathis - *ScanSource, Inc. - CFO*

Yes.

Chris Quilty - *Raymond James - Analyst*

Assuming you have more acquisitions that you could potentially layer on.

Charlie Mathis - *ScanSource, Inc. - CFO*

Let me just go back to one of your questions here that you were asking. I just want to make clear of this, that this was not an auction process. I just want to make sure you understand that this was not an auction process. This was a strategic fit that both buyers and sellers agreed upon and it made sense, so that's how the thing has come about. As far as --

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Mike Baur - *ScanSource, Inc. - CEO*

Charlie just give up the goods there.

Charlie Mathis - *ScanSource, Inc. - CFO*

Well, I thought it would need to make that clear for the other side to make sure to clarify that at least, because it was not that process. As far as the debt to EBITDA and as far as our capital structure goes, we're looking to move to a more optimal capital structure. To have $200 million of cash on the balance sheet, we don't believe that's nearly the right capital structure. So were looking to improve that and by doing so through acquisitions, through growing organically and also to do share repurchase.

Operator

We're showing no further questions at this time.

(Operator Instructions).

We are still showing no further questions at this time.

Mike Baur - *ScanSource, Inc. - CEO*

Thank you very much for joining us. We expect to hold our next conference call to discuss September 30 quarterly earnings results on October 30, 2014. Thank you.

Operator

That concludes today's conference. Thank you for participating. You may disconnect at this time.