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FORM 10-Q

SCANSOURCE INC - SCSC

Filed: May 05, 2015 (period: March 31, 2015)

Quarterly report with a continuing view of a company's financial position

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the
Quarterly period ended March 31, 2015**

Commission File Number: 000-26926



ScanSource, Inc.

(Exact name of registrant as specified in its charter)

SOUTH CAROLINA
(State or other jurisdiction of
incorporation or organization)

57-0965380
(I.R.S. Employer
Identification No.)

6 Logue Court
Greenville, South Carolina, 29615
(Address of principal executive offices)
(864) 288-2432
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post to such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at April 30, 2015
Common Stock, no par value per share	28,619,898 shares

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FORWARD-LOOKING STATEMENTS

The forward-looking statements included in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Quantitative and Qualitative Disclosures About Market Risk" and "Risk Factors" sections and elsewhere herein, which reflect our best judgment based on factors currently known, involve risks and uncertainties. Words such as "expects," "anticipates," "believes," "intends," "plans," "hopes," "forecasts," "seeks," "estimates," "goals," "projects," "strategy," "future," "likely," "may," "should," and variations of such words and similar expressions are intended to identify such forward-looking statements. Any forward-looking statement made by us in this Form 10-Q is based only on information currently available to us and speaks only as of the date on which it is made. Except as may be required by law, we expressly disclaim any obligation to update these forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors including, but not limited to, the factors discussed in such sections and, in particular, those set forth in the cautionary statements included in "Risk Factors" contained in our Annual Report on Form 10-K for the year ended June 30, 2014. The forward-looking information we have provided in this Quarterly Report on Form 10-Q pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995, should be evaluated in the context of these factors.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

SCANSOURCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except share information)

	March 31, 2015	June 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 93,578	\$ 194,851
Accounts receivable, less allowance of \$30,859 at March 31, 2015 and \$26,257 at June 30, 2014	487,148	464,405
Inventories	485,603	504,758
Prepaid expenses and other current assets	47,145	33,558
Deferred income taxes	20,879	18,109
Total current assets	1,134,353	1,215,681
Property and equipment, net	47,401	31,823
Goodwill	64,848	32,342
Other non-current assets, including net identifiable intangible assets	100,317	55,278
Total assets	\$ 1,346,919	\$ 1,335,124
Liabilities and Shareholders' Equity		
Current liabilities:		
Current debt	\$ 5,171	\$ —
Accounts payable	392,396	421,721
Accrued expenses and other current liabilities	71,132	63,574
Current portion of contingent consideration	9,955	5,851
Income taxes payable	2,328	8,685
Total current liabilities	480,982	499,831
Deferred income taxes	3,636	185
Long-term debt	6,696	5,429
Long-term portion of contingent consideration	21,403	5,256
Other long-term liabilities	35,151	21,780
Total liabilities	547,868	532,481
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 3,000,000 shares authorized, none issued	—	—
Common stock, no par value; 45,000,000 shares authorized, 28,594,872 and 28,539,481 shares issued and outstanding at March 31, 2015 and June 30, 2014, respectively	171,084	168,447
Retained earnings	699,868	650,896
Accumulated other comprehensive income (loss)	(71,901)	(16,700)
Total shareholders' equity	799,051	802,643
Total liabilities and shareholders' equity	\$ 1,346,919	\$ 1,335,124

June 30, 2014 amounts are derived from audited consolidated financial statements.

See accompanying notes to these condensed consolidated financial statements.

SCANSOURCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED INCOME STATEMENTS (UNAUDITED)
(In thousands, except per share data)

	Quarter ended March 31,		Nine months ended March 31,	
	2015	2014	2015	2014
Net sales	\$ 763,203	\$ 682,998	\$ 2,361,941	\$ 2,155,520
Cost of goods sold	683,187	609,647	2,126,168	1,928,414
Gross profit	80,016	73,351	235,773	227,106
Selling, general and administrative expenses	58,235	46,705	158,047	143,541
Change in fair value of contingent consideration	285	981	1,262	2,218
Operating income	21,496	25,665	76,464	81,347
Interest expense	891	217	1,288	698
Interest income	(731)	(545)	(2,057)	(1,644)
Other (income) expense, net	1,515	13	2,238	65
Income before income taxes	19,821	25,980	74,995	82,228
Provision for income taxes	6,878	9,031	26,023	27,544
Net income	\$ 12,943	\$ 16,949	\$ 48,972	\$ 54,684
Per share data:				
Net income per common share, basic	\$ 0.45	\$ 0.59	\$ 1.71	\$ 1.93
Weighted-average shares outstanding, basic	28,646	28,502	28,590	28,275
Net income per common share, diluted	\$ 0.45	\$ 0.59	\$ 1.70	\$ 1.92
Weighted-average shares outstanding, diluted	28,855	28,730	28,825	28,548

See accompanying notes to these condensed consolidated financial statements.

SCANSOURCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
(In thousands)

	Quarter ended March 31,		Nine months ended March 31,	
	2015	2014	2015	2014
Net income	\$ 12,943	\$ 16,949	\$ 48,972	\$ 54,684
Foreign currency translation adjustment	(31,899)	1,562	(55,201)	5,458
Comprehensive income (loss)	<u>\$ (18,956)</u>	<u>\$ 18,511</u>	<u>\$ (6,229)</u>	<u>\$ 60,142</u>

See accompanying notes to these condensed consolidated financial statements.

SCANSOURCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Nine months ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 48,972	\$ 54,684
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,050	5,391
Amortization of debt issuance costs	223	238
Provision for doubtful accounts	(2,120)	5,469
Share-based compensation	4,740	3,807
Deferred income taxes	4,910	10,981
Excess tax benefits from share-based payment arrangements	(260)	(982)
Change in fair value of contingent consideration	1,262	2,218
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	23,044	13,340
Inventories	23,759	(74,461)
Prepaid expenses and other assets	(140)	(2,924)
Other non-current assets	384	3,790
Accounts payable	(78,497)	12,404
Accrued expenses and other liabilities	(1,359)	(2,817)
Income taxes payable	(5,831)	1,532
Net cash provided by (used in) operating activities	27,137	32,670
Cash flows from investing activities:		
Capital expenditures	(19,854)	(6,785)
Cash paid for business acquisitions, net of cash acquired	(59,740)	—
Net cash provided by (used in) investing activities	(79,594)	(6,785)
Cash flows from financing activities:		
Borrowings (repayments) on short-term borrowings, net	(27,952)	—
Borrowings on revolving credit	93,579	—
Repayments on revolving credit	(93,579)	—
Debt issuance costs	—	(468)
Repayments on long-term debt	(318)	—
Repayments on capital lease obligation	(201)	—
Contingent consideration payments	(5,640)	(3,793)
Exercise of stock options	379	12,152
Repurchase of common stock	(2,694)	—
Excess tax benefits from share-based payment arrangements	260	982
Net cash provided by (used in) financing activities	(36,166)	8,873
Effect of exchange rate changes on cash and cash equivalents	(12,650)	640
Increase (decrease) in cash and cash equivalents	(101,273)	35,398
Cash and cash equivalents at beginning of period	194,851	148,164
Cash and cash equivalents at end of period	\$ 93,578	\$ 183,562

See accompanying notes to these condensed consolidated financial statements.

SCANSOURCE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Business and Summary of Significant Accounting Policies

Business Description

ScanSource, Inc. is a leading international wholesale distributor of specialty technology products. ScanSource, Inc. and its subsidiaries ("the Company") provide value-added distribution services for technology manufacturers and sell to resellers in the following specialty technology markets: POS and Barcode, Security and 3D Printing through its Worldwide Barcode & Security segment and video, voice, and network solutions through its Worldwide Communications & Services segment.

The Company operates in the United States, Canada, Latin America and Europe. The Company distributes to the United States and Canada from its Southaven, Mississippi distribution center; to Latin America principally from distribution centers located in Florida, Mexico, Brazil and Colombia; and to Europe from distribution centers located in Belgium, France, Germany and the United Kingdom.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of ScanSource, Inc. have been prepared by the Company's management in accordance with United States generally accepted accounting principles ("US GAAP") for interim financial information and applicable rules and regulations of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by US GAAP for annual financial statements. The unaudited condensed consolidated financial statements included herein contain all adjustments (consisting of normal recurring and non-recurring adjustments) which are, in the opinion of management, necessary to present fairly the financial position as of March 31, 2015 and June 30, 2014, the results of operations for the quarters and nine months ended March 31, 2015 and 2014, the statements of comprehensive income for the quarters and nine months ended March 31, 2015 and 2014 and the statements of cash flows for the nine months ended March 31, 2015 and 2014. The results of operations for the quarters and nine months ended March 31, 2015 and 2014 are not necessarily indicative of the results to be expected for a full year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

Summary of Significant Accounting Policies

Except as described below, there have been no material changes to the Company's significant accounting policies for the nine months ended March 31, 2015 from the information included in the notes to the Company's consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2014. For a discussion of the Company's significant accounting policies, please see the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less, when purchased, to be cash equivalents. The Company maintains some zero-balance, disbursement accounts at various financial institutions in which the Company does not maintain significant depository relationships. Due to the nature of the Company's banking relationships with these institutions, the Company does not have the right to offset most if not all outstanding checks written from these accounts against cash on hand, and the respective institutions are not legally obligated to honor the checks until sufficient funds are transferred to fund the checks. Checks released but not yet cleared from these accounts in the amounts of \$47.9 million and \$84.1 million are included in accounts payable as of March 31, 2015 and June 30, 2014, respectively.

Recent Accounting Pronouncements

In May 2014, the FASB issued a comprehensive new revenue recognition standard for contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of this standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, the standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction

price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. This guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early application is prohibited. The standard permits the use of either the retrospective or cumulative effect transition method. This guidance will be applicable to the Company for the fiscal year beginning July 1, 2017, which is the first quarter of fiscal year 2018. The Company is currently evaluating the impact on its consolidated financial statements upon the adoption of this new standard.

(2) Earnings Per Share

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share are computed by dividing net income by the weighted-average number of common and potential common shares outstanding.

	Quarter ended March 31,		Nine months ended March 31,	
	2015	2014	2015	2014
<i>(in thousands, except per share data)</i>				
Numerator:				
Net Income	\$ 12,943	\$ 16,949	\$ 48,972	\$ 54,684
Denominator:				
Weighted-average shares, basic	28,646	28,502	28,590	28,275
Dilutive effect of share-based payments	209	228	235	273
Weighted-average shares, diluted	28,855	28,730	28,825	28,548
Net income per common share, basic	\$ 0.45	\$ 0.59	\$ 1.71	\$ 1.93
Net income per common share, diluted	\$ 0.45	\$ 0.59	\$ 1.70	\$ 1.92

For the quarter and nine months ended March 31, 2015, weighted-average shares outstanding excluded from the computation of diluted earnings per share because their effect would be anti-dilutive were 426,045 and 339,510, respectively. For the quarter and nine months ended March 31, 2014, there were 275,635 and 203,384 weighted-average shares outstanding excluded from the computation of diluted earnings per share because their effect would be anti-dilutive.

(3) Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following:

	March 31, 2015	June 30, 2014
<i>(in thousands)</i>		
Foreign currency translation adjustment	\$ (71,901)	\$ (16,700)
Accumulated other comprehensive income (loss)	\$ (71,901)	\$ (16,700)

The tax effect of amounts in comprehensive income (loss) reflect a tax expense or benefit as follows:

	Quarter ended March 31,		Nine Months ended March 31,	
	2015	2014	2015	2014
<i>(in thousands)</i>				
Tax expense (benefit)	\$ 1,090	\$ (165)	\$ 2,376	\$ (184)

(4) Acquisitions*Imago*

On September 19, 2014, the Company acquired 100% of the shares of Imago Group plc, a European value-added distributor of video and voice communications equipment and services, through a newly-formed special purchase entity. Subsequent to the acquisition, the Company changed Imago's name to ScanSource Video Communications Ltd. (dba Imago ScanSource). Imago ScanSource joins the Company's Worldwide Communications and Services operating segment. This acquisition supports the Company's strategy to be the leading value-added distributor of video, voice, and networking solutions for resellers in Europe.

Under the Share Purchase Agreement, the Company structured the purchase transaction with an initial cash payment of \$37.4 million, plus two additional annual cash installments for the twelve month periods ending September 30, 2015 and 2016, based on the financial performance of Imago ScanSource. The Company acquired \$1.9 million of cash during the acquisition, resulting in net \$35.5 million cash paid for Imago ScanSource. Please see Note 8, *Fair Value of Financial Instruments* for further information regarding the fair value accounting for this contingent consideration.

Pro forma results of operations and a complete purchase price allocation have not been presented for this acquisition because the results of this acquisition are not material to our consolidated results. The purchase price of this acquisition was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the transaction date, resulting in goodwill and identifiable intangible assets. As of the date of this report, the finalization of purchase accounting adjustments is incomplete, therefore, estimates provided are subject to change. The purchase price allocated to goodwill and identifiable intangible assets as of the acquisition date is estimated as follows:

	Goodwill	Identifiable Intangible Assets
	(in thousands)	
Imago ScanSource	\$ 18,620	\$ 19,606

Intangible assets acquired include trade names, customer relationships, and non-compete agreements.

For tax purposes, due to the nondeductible nature of the amortization of identifiable intangible assets acquired, the Company recorded a deferred tax liability in the amount of \$4.1 million. The deferred tax liability represents the difference between the book and tax bases in the assets and will decrease over time as the assets are amortized for book purposes.

Network1

On January 13, 2015, the Company acquired 100% of the shares of Intersmart Comércio Importação Exportação de Equipamentos Eletrônicos, S.A., a corporation organized under the laws of the Federative Republic of Brazil, and its related entities (collectively "Network1") from the Network1 shareholders. Network1 is a Brazilian value-added distributor of communications equipment and services and joins the Company's Worldwide Communications and Services operating segment. ScanSource is committed to becoming the leading value-added distributor of communications solutions for resellers in Latin America, and this acquisition represents an important step in this strategy.

Under the Share Purchase Agreement, the Company structured the purchase transaction with an initial cash payment of approximately \$29.1 million, plus additional annual cash installments based on a form of adjusted earnings before interest expense, taxes, depreciation and amortization ("adjusted EBITDA") over the next four years, commencing with the period ending June 30, 2015. The Company acquired \$4.8 million of cash during the acquisition, resulting in \$24.2 million net cash paid for Network1. The Company assumed net debt of \$34.7 million as part of the initial purchase consideration.

Pro forma results of operations and a complete purchase price allocation have not been presented for this acquisition because the results of this acquisition are not material to our consolidated results. The purchase price of this acquisition was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the transaction date. As of the date of this report, initial purchase accounting for the business combination, which includes valuation of the pre-acquisition contingencies and related indemnification receivables, contingent consideration, intangible assets, and certain tangible assets, has not been finalized, therefore, purchase price allocation estimates presented are subject to change. Please see Note 8, *Fair Value of Financial Instruments* for further information regarding the fair value accounting for this contingent consideration and Note 10, *Commitments and Contingencies* for further information regarding pre-acquisition contingencies and related indemnification receivables.

	Goodwill	Identifiable Intangible Assets
	(in thousands)	
Network1	\$ 22,014	\$ 23,561

Intangible assets acquired include trade names, customer relationships, and non-compete agreements.

(5) Goodwill and Other Identifiable Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended March 31, 2015, by reporting segment, are as follows:

	Barcode & Security Segment	Communications & Services Segment	Total
	(in thousands)		
Balance as of June 30, 2014	\$ 16,876	\$ 15,466	\$ 32,342
Additions	—	40,634	40,634
Foreign currency translation adjustment	(1,671)	(6,457)	(8,128)
Balance as of March 31, 2015	\$ 15,205	\$ 49,643	\$ 64,848

Included within other non-current assets in the Condensed Consolidated Balance Sheets are net identifiable intangible assets of \$46.9 million and \$16.0 million at March 31, 2015 and June 30, 2014, respectively. The increase in net identifiable intangible assets is due to those acquired related to the Imago ScanSource and Network1 acquisitions. These amounts relate to acquired intangible assets including trade names, customer relationships, non-compete agreements, and distributor agreements.

(6) Short-Term Borrowings and Long-Term Debt

Short-Term Borrowings

Imago ScanSource has multi-currency invoice discounting credit facilities secured by the subsidiary's assets for its operations based in the United Kingdom and France. The invoice discounting facilities allow for the issuance of funds up to 85% of the amount of each invoice processed, subject to limits by currency of £4.1 million, €4.1 million, and \$0.7 million. Borrowings under the invoice discounting facilities bear interest at a base rate determined by currency, plus a spread of 1.85%. The base rate is the United Kingdom base rate published by the Bank of England for GBP-based borrowings, 30-day Euro Interbank Offered Rate ("EUROLIBOR") for Euro-based borrowings, and the Lloyds Bank daily USD published rate for the USD-based borrowings. Additionally, the Company is assessed an annual commitment fee of less than £0.1 million. There were no outstanding balances at March 31, 2015.

Network1, a subsidiary of the Company, has a term loan agreement, denominated in the US dollar, with Banco Santander to provide funding for working capital needs. The loan is secured by accounts receivable of the subsidiary and a personal guarantee of a former shareholder. In general, in the absence of an event of default, the term loan matures on May 18, 2015. The terms of the loan provide for payment upon maturity and bear interest at 2.09% per annum. The loan possesses a cross currency swap contract which bears interest at a base rate equal to the Average One-Day Interbank Deposit Rate ("CDI" rate), plus a spread of 1.84% per annum. The CDI interest rate at March 31, 2015 was approximately 12.6%. As of March 31, 2015, the subsidiary was in compliance with all covenants under this loan. The outstanding balance as of March 31, 2015 was \$1.5 million.

Revolving Credit Facility

The Company has a \$300 million multi-currency senior secured revolving credit facility that was scheduled to mature on October 11, 2016. On November 6, 2013, the Company entered into an amendment of this credit facility ("Amended Credit Agreement") with JPMorgan Chase Bank N.A., as administrative agent, and a syndicate of banks to extend its maturity to November 6, 2018. The Amended Credit Agreement allows for the issuance of up to \$50 million for letters of credit and has a \$150 million accordion feature that allows the Company to increase the availability to \$450 million, subject to obtaining additional credit commitments for the lenders participating in the increase. The Company incurred debt issuance costs of \$0.5 million in connection with the Amended Credit Agreement, which were capitalized to other assets on the Condensed Consolidated Balance Sheets and added to the unamortized debt issuance costs from the previous credit facility.

At the Company's option, loans denominated in U.S. dollars under the Amended Credit Agreement, other than swingline loans, bear interest at a rate equal to a spread over the London Interbank Offered Rate ("LIBOR") or alternate base rate depending upon the Company's ratio of total debt (excluding accounts payable and accrued liabilities), measured as of the end of the most recent quarter, to adjusted earnings before interest expense, taxes, depreciation and amortization ("EBITDA") for the most recently completed four quarters (the "Leverage Ratio"). The Leverage Ratio calculation excludes the Company's subsidiaries in Brazil. This spread ranges from 1.00% to 2.25% for LIBOR-based loans and 0.00% to 1.25% for alternate base rate loans. The spread in effect for the period ended March 31, 2015 was 1.00% for LIBOR-based loans and 0.00% for alternate base rate loans. Additionally, the Company is assessed commitment fees ranging from 0.175% to 0.40%, depending upon the Leverage Ratio, on non-utilized borrowing availability, excluding swingline loans. The commitment fee rate in effect for the period ended March 31, 2015 was 0.175%. Borrowings are guaranteed by substantially all of the domestic assets of the Company and a pledge of up to 65% of capital stock or other equity interest in certain foreign subsidiaries determined to be either material or a subsidiary borrower as defined in the Amended Credit Agreement. The Company was in compliance with all covenants under the credit facility as of March 31, 2015. There were no outstanding balances at March 31, 2015 and June 30, 2014.

The average daily balance during the nine month period ended March 31, 2015 and 2014 was \$2.2 million and \$0.0 million, respectively. There was \$300 million available for additional borrowings as of March 31, 2015 and 2014, and there were no letters of credit issued under the revolving credit facility.

Long-Term Debt

On August 1, 2007, the Company entered into an agreement with the State of Mississippi to provide financing for the acquisition and installation of certain equipment to be utilized at the Company's Southaven, Mississippi distribution facility, through the issuance of an industrial development revenue bond. The bond matures on September 1, 2032 and accrues interest at the 30-day LIBOR rate plus a spread of 0.85%. The terms of the bond allow for payment of interest only for the first 10 years of the agreement, and then, starting on September 1, 2018 through 2032, principal and interest payments are due until the maturity date or the redemption of the bond. The agreement also provides the bondholder with a put option, exercisable only within 180 days of each fifth anniversary of the agreement, requiring the Company to pay back the bonds at 100% of the principal amount outstanding. As of March 31, 2015, the Company was in compliance with all covenants under this bond. The balance on the bond was \$5.4 million as of March 31, 2015 and June 30, 2014 and is included in long-term debt. The interest rate at March 31, 2015 and June 30, 2014 was 1.02% and 1.00%, respectively.

Network1 has multiple term loan agreements, denominated in Brazilian reais, with Banco Bradesco, to provide funding for working capital needs. The agreements are collectively secured by accounts receivable of the subsidiary and a personal guarantee by a former shareholder. In general, in the absence of an event of default, the term loans mature on May 9, 2016. The terms of the loans provide for bi-annual payments of varying amounts and bear interest at 11.48% per annum. As of March 31, 2015, the subsidiary was in compliance with all covenants under this loan. The outstanding balance as of March 31, 2015 was \$2.6 million, of which \$1.9 million is classified as current.

Network1 holds a term loan agreement, denominated in the Brazilian real, with Banco do Brasil to provide funding for working capital needs. The loan is secured by accounts receivable of the subsidiary and a personal guarantee by a former shareholder. In general, in the absence of an event of default, the term loan matures on October 28, 2017. The terms of the loan provide for monthly payments and bear interest at 12.08% per annum. As of March 31, 2015, the subsidiary was in compliance with all covenants under this loan. The outstanding balance as of March 31, 2015 was \$1.0 million, of which \$0.4 million is classified as current.

Network1 holds a term loan agreement, denominated in the US dollar, with Banco Safra to provide funding for working capital needs. The loan is secured by accounts receivable of the subsidiary. In general, in the absence of an event of default, the term loan matures on September 21, 2015. The terms of the loan provide for quarterly payments and bear interest at 3.6% per annum. The loan possesses a cross currency swap contract which bears interest at a base rate equal to the CDI rate, plus a spread 2.75% per annum. The CDI interest rate at March 31, 2015 was approximately 12.6%. As of March 31, 2015, the subsidiary was in compliance with all covenants under this loan. The outstanding balance as of March 31, 2015 was \$1.3 million, all of which is classified as current.

Please see Note 7, *Derivatives and Hedging Activities* for further information regarding the cross currency swaps.

Debt Issuance Costs

As of March 31, 2015, net debt issuance costs associated with the credit facility and bonds totaled \$1.1 million and are being amortized on a straight-line basis through the maturity date of each respective debt instrument.

(7) Derivatives and Hedging Activities

The Company's results of operations could be materially impacted by significant changes in foreign currency exchange rates and interest rates. These risks and the management of these risks are discussed in greater detail below. In an effort to manage the exposure to these risks, the Company periodically enters into various derivative instruments. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with US GAAP. The Company records all derivatives on the balance sheet at fair value. Derivatives that are not designated as hedging instruments or the ineffective portions of cash flow hedges are adjusted to fair value through earnings in other income and expense.

Foreign Currency Derivatives – The Company conducts a portion of its business internationally in a variety of foreign currencies. The exposure to market risk for changes in foreign currency exchange rates arises from foreign currency-denominated assets and liabilities, and transactions arising from non-functional currency financing or trading activities. The Company's objective is to preserve the economic value of non-functional currency-denominated cash flows. The Company attempts to hedge transaction exposures with natural offsets to the fullest extent possible and, once these opportunities have been exhausted, through forward contracts or other hedging instruments with third parties. These contracts will periodically hedge the exchange of various currencies, including the U.S. dollar, euro, British pound, Canadian dollar, Mexican peso, Colombian peso, Chilean peso and Brazilian real. While the Company utilizes foreign exchange contracts to hedge foreign currency exposure, the Company's foreign exchange policy prohibits the use of derivative financial instruments for speculative purposes.

The Company had contracts outstanding for purposes of managing cash flows with notional amounts of \$84.7 million and \$62.5 million for the exchange of foreign currencies as of March 31, 2015 and June 30, 2014, respectively. To date, the Company has chosen not to designate these derivatives as hedging instruments, and accordingly, these instruments are adjusted to fair value through earnings in other income and expense. Summarized financial information related to these derivative contracts and changes in the underlying value of the foreign currency exposures are as follows:

	Quarter ended		Nine months ended	
	March 31,		March 31,	
	2015	2014	2015	2014
	(in thousands)			
Net foreign exchange derivative contract (gains) losses	\$ (3,255)	\$ 114	\$ (6,741)	\$ 2,511
Net foreign currency transactional and re-measurement (gains) losses	4,881	(57)	9,347	(2,185)
Net foreign currency (gains) losses	\$ 1,626	\$ 57	\$ 2,606	\$ 326

Net foreign exchange gains and losses consist of foreign currency transactional and functional currency re-measurements, offset by net foreign currency exchange contract gains and losses and are included in other income and expense. Foreign exchange gains and losses are generated as the result of fluctuations in the value of the British pound versus the euro, the U.S. dollar versus the euro, the U.S. dollar versus the Brazilian real and other currencies versus the U.S. dollar.

Cross Currency Swaps – Through the acquisition of Network1, the Company has borrowings denominated in foreign currencies that have primarily been hedged into the functional currency of the respective borrowing entity using cross currency swaps in order to mitigate the impact of foreign currency exposures and interest rate exposures on these borrowings. These swaps involve the exchange of principal and fixed interest receipts of U.S. dollar-denominated debt held by one of our Brazilian subsidiaries (Network1) for principal and variable interest payments in Brazilian reais. The impact of the changes in foreign exchange rates of the cross currency debt instruments are recognized as adjustments to other income and expense in the Condensed Consolidated Income Statements. Interest rate differentials paid or received under the swap agreements are recognized as adjustments to interest expense in the Condensed Consolidated Income Statements, which totaled approximately \$0.4 million during the quarter ended March 31, 2015. The fair value of the swaps was a receivable of \$0.7 million as of March 31, 2015 and is included in prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets.

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The Company used the following derivative instruments, located on its Condensed Consolidated Balance Sheets, for the risk management purposes detailed above:

	As of March 31, 2015			
	Fair Value of Derivatives Designated as Hedge Instruments		Fair Value of Derivatives Not Designated as Hedge Instruments	
	<i>(in thousands)</i>			
Derivative assets: ^(a)				
Forward foreign currency exchange contracts	\$	—	\$	9
Cross currency swap agreements	\$	—	\$	651
Derivative liabilities: ^(b)				
Forward foreign currency exchange contracts	\$	—	\$	571

(a) All derivative assets are recorded as prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets.

(b) All derivative liabilities are recorded as accrued expenses and other current liabilities in the Condensed Consolidated Balance Sheets.

(8) Fair Value of Financial Instruments

Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the Company is required to classify certain assets and liabilities based on the fair value hierarchy, which groups fair value measured assets and liabilities based upon the following levels of inputs:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 – Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity).

The assets and liabilities maintained by the Company that are required to be measured or disclosed at fair value on a recurring basis include the Company's various debt instruments, deferred compensation plan investments, outstanding foreign exchange forward contracts, cross currency swap agreements and contingent consideration owed to the previous owners of Brasil Distribuidora de Tecnologias Especiais LTDA ("CDC" or "ScanSource Brasil"), Imago ScanSource and Network1. The carrying value of debt is considered to approximate fair value, as the Company's debt instruments are either indexed to a variable rate using the market approach (Level 2 criteria) or the fixed rate applied approximates the variable rate published as of March 31, 2015.

The following table summarizes the valuation of the Company's remaining assets and liabilities measured at fair value on a recurring basis as of March 31, 2015:

	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<i>(in thousands)</i>				
Assets:				
Deferred compensation plan investments, current and non-current portion	\$ 15,791	\$ 15,791	\$ —	\$ —
Forward foreign currency exchange contracts	9	—	9	—
Cross currency swap agreements	651	—	651	—
Total assets at fair value	<u>\$ 16,451</u>	<u>\$ 15,791</u>	<u>\$ 660</u>	<u>\$ —</u>
Liabilities:				
Deferred compensation plan investments, current and non-current portion	\$ 15,791	\$ 15,791	\$ —	\$ —
Forward foreign currency exchange contracts	571	—	571	—
Liability for contingent consideration, current and non-current portion	31,358	—	—	31,358
Total liabilities at fair value	<u>\$ 47,720</u>	<u>\$ 15,791</u>	<u>\$ 571</u>	<u>\$ 31,358</u>

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The following table summarizes the valuation of the Company's remaining assets and liabilities measured at fair value on a recurring basis as of June 30, 2014:

	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(in thousands)				
Assets:				
Deferred compensation plan investments, current and non-current portion	\$ 14,044	\$ 14,044	\$ —	\$ —
Forward foreign currency exchange contracts	65	—	65	—
Total assets at fair value	<u>\$ 14,109</u>	<u>\$ 14,044</u>	<u>\$ 65</u>	<u>\$ —</u>
Liabilities:				
Deferred compensation plan investments, current and non-current portion	\$ 14,044	\$ 14,044	\$ —	\$ —
Forward foreign currency exchange contracts	119	—	119	—
Liability for contingent consideration, current and non-current portion	11,107	—	—	11,107
Total liabilities at fair value	<u>\$ 25,270</u>	<u>\$ 14,044</u>	<u>\$ 119</u>	<u>\$ 11,107</u>

The investments in the deferred compensation plan are held in a rabbi trust and include mutual funds and cash equivalents for payment of non-qualified benefits for certain retired, terminated or active employees. These investments are recorded to prepaid expenses and other current assets or other non-current assets depending on their corresponding, anticipated distributions to recipients, which are reported in accrued expenses and other current liabilities or other long-term non-current liabilities, respectively.

Derivative instruments, such as, foreign currency forward contracts and cross currency swap agreements are measured using the market approach on a recurring basis considering foreign currency spot rates and forward rates quoted by banks or foreign currency dealers and interest rates quoted by banks (Level 2). See Note 7 - *Derivatives and Hedging Activities*. Foreign currency contracts and cross currency swap agreements are classified in the consolidated balance sheet as prepaid expenses and other current assets or accrued expenses and other current liabilities, depending on the respective instruments' favorable or unfavorable positions.

The Company recorded contingent consideration liabilities at the acquisition date of CDC, Imago ScanSource and Network1 representing the amounts payable to former shareholders, as outlined under the terms of the Share Purchase Agreements, based upon the achievement of a projected earnings measure, net of specific pro forma adjustments. The current and non-current portions of these obligations are reported separately on the Condensed Consolidated Balance Sheets. The fair value of the contingent considerations (Level 3) are determined using a form of a probability weighted discounted cash flow model. Subsequent changes in the fair value of the contingent consideration liabilities are recorded to the change in fair value of contingent consideration line item in the Condensed Consolidated Income Statements. Fluctuations due to foreign currency translation are captured in other comprehensive income through the changes in foreign currency translation adjustments line item as seen in Note 3 - *Accumulated Other Comprehensive Income (Loss)*.

CDC is part of the Company's Worldwide Barcode and Security Segment, and Imago ScanSource and Network1 are part of the Company's Worldwide Communications and Services segment.

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The table below provides a summary of the changes in fair value of the Company's contingent considerations (Level 3) for the CDC, Imago ScanSource and Network1 earnouts for the quarter and nine months ended March 31, 2015:

	Contingent consideration for the quarter ended			Contingent consideration for the nine months ended		
	March 31, 2015			March 31, 2015		
	Barcode & Security Segment	Communications & Services Segment	Total	Barcode & Security Segment	Communications & Services Segment	Total
<i>(in thousands)</i>						
Fair value at beginning of period	\$ 4,952	\$ 5,053	\$ 10,005	\$ 11,107	\$ —	\$ 11,107
Issuance of contingent consideration	—	27,052	27,052	—	32,035	32,035
Payments	(111)	—	(111)	(5,640)	—	(5,640)
Change in fair value of contingent consideration	172	113	285	830	432	1,262
Foreign currency translation adjustment	(853)	(5,020)	(5,873)	(2,137)	(5,269)	(7,406)
Fair value at end of period	\$ 4,160	\$ 27,198	\$ 31,358	\$ 4,160	\$ 27,198	\$ 31,358

The table below provides a summary of the changes in fair value of the Company's contingent considerations (Level 3) for the CDC earnout for the quarter and nine months ended March 31, 2014:

	Contingent consideration for the quarter ended			Contingent consideration for the nine months ended		
	March 31, 2014			March 31, 2014		
	Barcode & Security Segment	Communications & Services Segment	Total	Barcode & Security Segment	Communications & Services Segment	Total
<i>(in thousands)</i>						
Fair value at beginning of period	\$ 9,547	\$ —	\$ 9,547	\$ 12,545	\$ —	\$ 12,545
Payments	(147)	—	(147)	(3,793)	—	(3,793)
Change in fair value of contingent consideration	981	—	981	2,218	—	2,218
Foreign currency translation adjustment	355	—	355	(234)	—	(234)
Fair value at end of period	\$ 10,736	\$ —	\$ 10,736	\$ 10,736	\$ —	\$ 10,736

The fair values of amounts owed are recorded in current portion of contingent consideration and long-term portion of contingent consideration in the Company's Condensed Consolidated Balance Sheets. The U.S. dollar amounts of actual disbursements made in connection with future earnout payments are subject to change as the liability is denominated in currencies other than the U.S. dollar and subject to foreign exchange fluctuation risk. The Company will revalue the contingent consideration liabilities at each reporting date through the last payment, with changes in the fair value of the contingent consideration reflected in the change in fair value of contingent consideration line item on the Company's Condensed Consolidated Income Statements that is included in the calculation of operating income. The fair value of the contingent consideration liabilities associated with future earnout payments is based on several factors, including:

- estimated future results, net of pro forma adjustments set forth in the Share Purchase Agreements;
- the probability of achieving these results; and
- a discount rate reflective of the Company's creditworthiness and market risk premium associated with the Brazilian and European markets.

A change in any of these unobservable inputs can significantly change the fair value of the contingent consideration.

Barcode and Security Segment

The fair value of the liability for the contingent consideration related to CDC recognized at March 31, 2015 was \$4.2 million, all of which is classified as current. The change in fair value of the contingent consideration recognized in the Condensed Consolidated Income Statements contributed a loss of \$0.2 million and \$0.8 million for the quarter and nine months ended March 31, 2015. The change for the quarter and year to date period is largely driven by the recurring amortization of the unrecognized fair value discount. In addition, volatility in the foreign exchange between the Brazilian real and the U.S. dollar has driven changes in the translation of this Brazilian real denominated liability. Although there is no contractual limit, total future undiscounted contingent consideration payments are anticipated to range up to \$4.4 million, based on the Company's best estimate of the earnout calculated on a multiple of adjusted earnings.

Communications and Services Segment

The fair value of the liability for the contingent consideration related to Imago ScanSource recognized at March 31, 2015 was \$4.9 million of which \$2.3 million is classified as current. The change in fair value of the contingent consideration recognized in the Condensed Consolidated Income Statements contributed a loss of \$0.1 million and \$0.4 million for the quarter and nine months ended March 31, 2015. The change for the quarter and year to date period is largely driven by the recurring amortization of the unrecognized fair value discount and changes in the probability assumption of future achievable results. In addition, volatility in the foreign exchange between the British pound and the U.S. dollar has driven changes in the translation of this British pound denominated liability. Although there is no contractual limit, total future undiscounted contingent consideration payments are anticipated to range between \$4.5 million and \$5.8 million, based on the Company's best estimate of the earnout calculated on a multiple of adjusted earnings, before interest expense, income taxes, depreciation and amortization.

The fair value of the liability for the contingent consideration related to Network1 recognized at March 31, 2015 was \$22.3 million of which \$3.5 million is classified as current. The change in fair value of the contingent consideration recognized in the Condensed Consolidated Income Statements contributed a loss of less than \$0.1 million for the quarter and nine months ended March 31, 2015. The change for the quarter and year to date period is largely driven by the recurring amortization of the unrecognized fair value discount, offset by less than expected actual results. In addition, volatility in the foreign exchange between the Brazilian real and the U.S. dollar has driven changes in the translation of this Brazilian real denominated liability. Although there is no contractual limit, total future undiscounted contingent consideration payments are anticipated to range up to \$30.7 million, based on the Company's best estimate of the earnout calculated on a multiple of adjusted earnings, before interest expense, income taxes, depreciation and amortization, plus the effects of foreign exchange.

(9) Segment Information

The Company is a leading distributor of specialty technology products, providing value-added distribution sales to resellers in specialty technology markets. The Company has two reportable segments, based on product and service type.

Worldwide Barcode & Security Segment

The Barcode & Security distribution segment focuses on automatic identification and data capture ("AIDC"), point-of-sale ("POS"), electronic physical security, and 3D printing technologies. We have business units within this segment for sales and merchandising functions, including ScanSource POS and Barcode business units in North America, Latin America, and Europe and the ScanSource Security business unit in North America. We see adjacencies among these technologies in helping our resellers develop solutions, such as with networking products. AIDC and POS products interface with computer systems used to automate the collection, processing and communication of information for commercial and industrial applications, including retail sales, distribution, shipping, inventory control, materials handling, warehouse management and health care applications. Electronic physical security products include identification, access control, video surveillance, intrusion-related and wireless and networking infrastructure products. 3D printing solutions replace and complement traditional methods and reduce the time and cost of designing new products by printing real parts directly from digital input.

Worldwide Communications & Services Segment

The Communications & Services distribution segment focuses on communications technologies and services. We have business units within this segment for sales and merchandising functions, and these business units offer voice, video conferencing, wireless, data networking and converged communications solutions in North America, Latin America, and Europe. As these solutions come together on IP networks, new opportunities are created for value-added resellers to move into adjacent solutions for all vertical markets, including education, healthcare, and government. ScanSource Services Group delivers value-added support programs and services, including education and training, network assessments, custom configuration, implementation and marketing to help resellers develop a new technology practice, or to extend their capability and reach.

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Selected financial information for each business segment is presented below:

	Quarter ended March 31,		Nine months ended March 31,	
	2015	2014	2015	2014
	<i>(in thousands)</i>			
Sales:				
Worldwide Barcode & Security	\$ 422,061	\$ 455,822	\$ 1,422,793	\$ 1,382,672
Worldwide Communications & Services	341,142	227,176	939,148	772,848
	<u>\$ 763,203</u>	<u>\$ 682,998</u>	<u>\$ 2,361,941</u>	<u>\$ 2,155,520</u>
Depreciation and amortization:				
Worldwide Barcode & Security	\$ 1,172	\$ 1,024	\$ 3,248	\$ 3,159
Worldwide Communications & Services	2,538	719	4,802	2,232
	<u>\$ 3,710</u>	<u>\$ 1,743</u>	<u>\$ 8,050</u>	<u>\$ 5,391</u>
Operating income:				
Worldwide Barcode & Security	\$ 10,327	\$ 13,820	\$ 36,444	\$ 38,734
Worldwide Communications & Services	11,461	11,845	43,136	42,613
Corporate ⁽¹⁾	(292)	—	(3,116)	—
	<u>\$ 21,496</u>	<u>\$ 25,665</u>	<u>\$ 76,464</u>	<u>\$ 81,347</u>
Capital expenditures:				
Worldwide Barcode & Security	\$ 508	\$ 204	\$ 686	\$ 507
Worldwide Communications & Services	521	130	822	249
Corporate	5,042	6,029	18,346	6,029
	<u>\$ 6,071</u>	<u>\$ 6,363</u>	<u>\$ 19,854</u>	<u>\$ 6,785</u>
Sales by Geography Category:				
North America	\$ 545,764	\$ 508,751	\$ 1,751,435	\$ 1,637,308
International	228,461	184,225	644,341	553,318
Less intercompany sales	(11,022)	(9,978)	(33,835)	(35,106)
	<u>\$ 763,203</u>	<u>\$ 682,998</u>	<u>\$ 2,361,941</u>	<u>\$ 2,155,520</u>

⁽¹⁾ For the quarter and nine months ended March 31, 2015, the amount shown includes acquisition costs.

	March 31, 2015	June 30, 2014
	<i>(in thousands)</i>	
Assets:		
Worldwide Barcode & Security	\$ 650,276	\$ 702,230
Worldwide Communications & Services	575,824	431,908
Corporate	120,819	200,986
	<u>\$ 1,346,919</u>	<u>\$ 1,335,124</u>
Property and equipment, net by Geography Category:		
North America	\$ 42,176	\$ 28,673
International	5,225	3,150
	<u>\$ 47,401</u>	<u>\$ 31,823</u>

(10) Commitments and Contingencies

The Company and its subsidiaries are, from time to time, parties to lawsuits arising out of operations. Although there can be no assurance, based upon information known to the Company, the Company believes that any liability resulting from an adverse determination of such lawsuits would not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

The Company is in the process of implementing a new Enterprise Resource Planning ("ERP") system. In December 2013, the Company retained SAP for software platform and implementation consulting services on the new ERP system. The Company's European operations, excluding Imago ScanSource, began utilizing the new ERP system during the third quarter of the current fiscal year. The Company is currently working on the implementation of the new ERP platform in North America. For the quarter and nine months ended March 31, 2015, the Company incurred \$3.5 million and \$15.3 million, respectively, in the form of capital expenditures related to the ERP project. Amounts in accrued expenses and other current liabilities related to capital expenditures totaled \$0.0 million and \$3.0 million as of March 31, 2015 and June 30, 2014, respectively. Total capital expenditures for fiscal 2015 could range from \$20 million to \$21 million.

During the Company's due diligence for the CDC and Network1 acquisitions, several pre-acquisition contingencies were identified regarding various Brazilian federal and state tax exposures. The Company is able to record indemnification receivables that are reported gross of the pre-acquisition contingency liabilities as they were escrowed or claimed against future earnout payments in the Share Purchase and Sale Agreement. However, indemnity claims can be made up to the entire purchase price, which includes the initial payment and all future earnout payments. The table below summarizes the balances and line item presentation of these pre-acquisition contingencies and corresponding indemnification receivables in the Company's Condensed Consolidated Balance Sheets as of March 31, 2015:

	CDC		Network1	
	(in thousands)			
Assets				
Prepaid expenses and other current assets	\$	3,053	\$	502
Other non-current assets	\$	67	\$	10,415
Liabilities				
Accrued expenses and other current liabilities	\$	3,053	\$	502
Other long-term liabilities	\$	67	\$	10,415

The table below summarizes the balances and line item presentation of these pre-acquisition contingencies and corresponding indemnification receivables in the Company's Condensed Consolidated Balance Sheets as of June 30, 2014:

	CDC		Network1	
	(in thousands)			
Assets				
Prepaid expenses and other current assets	\$	5,023	\$	—
Other non-current assets	\$	1,221	\$	—
Liabilities				
Accrued expenses and other current liabilities	\$	5,023	\$	—
Other long-term liabilities	\$	1,221	\$	—

Changes in these contingent liabilities and receivables from June 30, 2014, are primarily driven by foreign currency translation and the addition of contingent liabilities assumed through the Network1 acquisition.

(11) Income Taxes

The Company had approximately \$1.3 million and \$1.2 million of total gross unrecognized tax benefits as of March 31, 2015 and June 30, 2014, respectively. Of this total at March 31, 2015, approximately \$0.8 million represents the amount of unrecognized tax benefits that are permanent in nature and, if recognized, would affect the annual effective tax rate. The Company does not believe that the total amount of unrecognized tax benefits will significantly increase or decrease within twelve months of the reporting date.

The Company conducts business globally and, as a result, one or more of its subsidiaries files income tax returns in the U.S. federal, various state, local and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities in countries and states in which it operates. With certain exceptions, the Company is no longer subject to state and local, or non-U.S. income tax examinations by tax authorities for the years before June 30, 2010.

The Company's policy is to recognize interest and penalties related to income tax matters in income tax expense. As of March 31, 2015, the Company had approximately \$1.3 million accrued for interest and penalties.

Income taxes for the interim period presented have been included in the accompanying condensed consolidated financial statements on the basis of an estimated annual effective tax rate. In addition to the amount of tax resulting from applying the estimated annual effective tax rate to pre-tax income, the Company includes certain items treated as discrete events to arrive at an estimated overall tax provision. There were no material discrete items during the period.

The Company's effective tax rate differs from the federal statutory rate of 35% primarily as a result of income derived from tax jurisdictions with varying income tax rates, nondeductible expenses, and state income taxes.

The Company has provided for U.S. income taxes for the current earnings of its Canadian subsidiary. Earnings from all other geographies will continue to be

considered retained indefinitely for reinvestment.

Financial results in prior quarters have generated pre-tax losses in Europe, which were primarily the result of our European Communications business, and could affect the valuation of certain deferred tax assets. In the judgment of management, it is more likely than not that the deferred tax asset will be realized.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

ScanSource, Inc. is a leading international wholesale distributor of specialty technology products. ScanSource, Inc. and its subsidiaries (the "Company") provide value-added distribution services for over 300 technology manufacturers and sell to approximately 35,000 resellers in the following specialty technology markets: POS and Barcode, Security, 3D Printing, and Communications.

The Company operates in the United States, Canada, Latin America and Europe. The Company distributes to the United States and Canada from its Southaven, Mississippi distribution center; to Latin America principally from distribution centers located in Florida, Mexico, Brazil and Colombia; and to Europe principally from distribution centers in Belgium, France, Germany and the United Kingdom.

The Company distributes products for many of its key vendors in all of its geographic markets; however certain vendors only allow distribution to specific geographies. The Company's key vendors in barcode technologies include Bematech, Cisco, Datalogic, Elo, Epson, Honeywell, Ingenico, Intermec by Honeywell, NCR, Toshiba Global Commerce Solutions, Verifone and Zebra. The Company's key vendors for security technologies include Arecont, Axis, Bosch, Cisco, Datacard, Exacq Technologies, Fargo, HID, March Networks, Panasonic, Ruckus Wireless, Samsung, Sony and Zebra Card. The Company's key vendors in communications technologies include Aruba, Avaya, AudioCodes, Cisco, Dialogic, Extreme Networks, Jabra, Meru Networks, Plantronics, Polycom, ShoreTel, Spectralink and Sonus.

On September 19, 2014, the Company acquired 100% of the shares of Imago Group plc, a European value-added distributor of video and voice communications equipment and services, through a newly-formed special purchase entity. Subsequent to the acquisition, the Company changed Imago's name to ScanSource Video Communications Ltd. (dba Imago ScanSource). Imago ScanSource is an addition to the Company's Worldwide Communications and Services operating segment. This acquisition supports the Company's strategy to be the leading value-added distributor of video, voice, and data solutions for resellers in Europe.

On January 13, 2015, the Company acquired 100% of the shares of Network1, a Brazilian value-added distributor of communications equipment and services. Network1 joins the Company's Worldwide Communications and Services operating segment. ScanSource is committed to becoming the leading value-added distributor of communications solutions for resellers in Latin America, and this acquisition represents an important step in this strategy.

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During fiscal year 2014, the Barcode & Security distribution segment added 3D printing solutions as a product offering targeting the manufacturing, healthcare, aerospace, and automotive markets. 3D printing solutions replace and complement traditional methods and reduce the time and cost of designing new products by printing real parts directly from digital input.

The Company operates under two segments: Worldwide Barcode & Security and Worldwide Communications & Services. The management structure for our reporting segments allows each worldwide segment to have its own president and globally leverages the Company's leadership in specific technology markets.

Our objective is to continue to grow profitable sales in the technologies we distribute. We continue to evaluate strategic acquisitions to enhance our technological and geographic portfolios, as well as introduce new product lines to our line card. In doing so, we face numerous challenges that require attention and resources. Certain business units and geographies continue to experience increased competition for the products we distribute. This competition may come in the form of pricing, credit terms, service levels and product availability. As this competition could affect both our market share and pricing of our products, we may change our strategy in order to effectively compete in the marketplace.

The Company is in the process of implementing a new Enterprise Resource Planning ("ERP") system. In December 2013, the Company retained SAP for software platform and implementation consulting services on the new ERP system. The Company's European operations, excluding Imago ScanSource, began utilizing the new ERP system on February 2, 2015. The Company is currently working on the implementation of the new ERP platform in North America. Given the global design of the Company's new ERP system, the Company is no longer capitalizing expenses associated with the implementation of the new ERP system, following the February 2015 implementation in Europe. ERP costs are included in selling, general and administrative costs ("SG&A").

Evaluating Financial Condition and Operating Performance

In addition to disclosing results that are determined in accordance with United States generally accepted accounting principles ("US GAAP"), we also disclose certain non-GAAP financial measures. These measures include non-GAAP operating income, non-GAAP net income, non-GAAP EPS, return on invested capital ("ROIC") and "constant currency," a measure that excludes the translation exchange impact from changes in foreign currency exchange rates between reporting periods. We use non-GAAP financial measures to better understand and evaluate performance, including comparisons from period to period.

These non-GAAP financial measures have limitations as analytical tools, and the non-GAAP financial measures that we report may not be comparable to similarly titled amounts reported by other companies. Analysis of results and outlook on a non-GAAP basis should be considered in addition to, and not in substitution for or as superior to, measurements of financial performance prepared in accordance with US GAAP.

Non-GAAP Operating Income, Non-GAAP Net Income and Non-GAAP EPS

To evaluate current period performance on a clearer and more consistent basis with prior periods, the Company discloses non-GAAP operating income, non-GAAP net income and non-GAAP diluted earnings per share. The Company completed acquisitions on September 19, 2014 and January 13, 2015, both of which were structured with earnout payments. Given the size of the acquisitions and potential variability of fair value adjustments on operating results, non-GAAP results exclude amortization of intangible assets related to acquisitions, change in fair value of contingent consideration, and acquisition costs. Non-GAAP operating income, non-GAAP pre-tax income, non-GAAP net income and non-GAAP diluted EPS are useful in better assessing and understanding the Company's operating performance, especially when comparing results with previous periods or forecasting performance for future periods.

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Below we are providing a non-GAAP reconciliation of operating income, net income and earnings per share adjusted for the costs and charges mentioned above:

	Quarter ended March 31, 2015				Quarter ended March 31, 2014			
	Operating Income	Pre-Tax Income	Net Income	Diluted EPS	Operating Income	Pre-Tax Income	Net Income	Diluted EPS
	<i>(in thousands)</i>							
GAAP Measures	\$ 21,496	\$ 19,821	\$ 12,943	\$ 0.45	\$ 25,665	\$ 25,980	\$ 16,949	\$ 0.59
Adjustments:								
Amortization of intangible assets	2,114	2,114	1,464	0.05	909	909	595	0.02
Change in fair value of contingent consideration	285	285	200	0.01	981	981	647	0.02
Acquisition costs	292	292	292	0.01	—	—	—	—
Non-GAAP measures	<u>\$ 24,187</u>	<u>\$ 22,512</u>	<u>\$ 14,899</u>	<u>\$ 0.52</u>	<u>\$ 27,555</u>	<u>\$ 27,870</u>	<u>\$ 18,191</u>	<u>\$ 0.63</u>

Return on Invested Capital

Management uses ROIC as a performance measurement to assess efficiency at allocating capital under the Company's control to generate returns. Management believes this metric balances the Company's operating results with asset and liability management, is not impacted by capitalization decisions and is considered to have a strong correlation with shareholder value creation. In addition, it is easily computed, communicated and understood. ROIC also provides management a measure of the Company's profitability on a basis more comparable to historical or future periods.

ROIC assists us in comparing our performance over various reporting periods on a consistent basis because it removes from our operating results the impact of items that do not reflect our core operating performance. Adjusted EBITDA excludes changes in fair value of contingent consideration and acquisition costs. We believe the calculation of ROIC provides useful information to investors and is an additional relevant comparison of our performance during the year. In addition, the Company's Board of Directors uses ROIC in evaluating business and management performance. Certain management incentive compensation targets are set and measured relative to ROIC.

We calculate ROIC as earnings before interest expense, income taxes, depreciation and amortization, plus change in fair value of contingent consideration and other non-GAAP adjustments ("adjusted EBITDA") divided by invested capital. Invested capital is defined as average equity plus average daily funded interest-bearing debt for the period. The following table summarizes annualized return on invested capital ratio for the quarters ended March 31, 2015 and 2014, respectively:

	Quarter ended March 31,	
	2015	2014
Return on invested capital ratio, annualized ^(a)	12.1%	15.3%

(a) The annualized EBITDA amount is divided by days in the quarter times 365 days per year (366 during leap years). There were 90 days in the current and prior year quarter.

The components of this calculation and reconciliation to our financial statements are shown on the following schedule:

	Quarter ended March 31,	
	2015	2014
	(in thousands)	
Reconciliation of net income to EBITDA:		
Net income (GAAP)	\$ 12,943	\$ 16,949
Plus: interest expense	891	217
Plus: income taxes	6,878	9,031
Plus: depreciation and amortization	3,710	1,743
EBITDA (non-GAAP)	24,422	27,940
Plus: Change in fair value of contingent consideration	285	981
Plus: Acquisition costs	\$ 292	\$ —
Adjusted EBITDA (numerator for ROIC) (non-GAAP) ^(a)	\$ 24,999	\$ 28,921
	Quarter ended March 31,	
	2015	2014
	(in thousands)	
Invested capital calculations:		
Equity – beginning of the quarter	\$ 818,748	\$ 751,446
Equity – end of the quarter	799,051	772,786
Add: Change in fair value of contingent consideration, net of tax	200	647
Add: Acquisition costs, net of tax ^(b)	292	—
Average equity	809,146	762,440
Average funded debt ^(c)	32,046	5,429
Invested capital (denominator for ROIC) (non-GAAP)	\$ 841,192	\$ 767,869

(a) Adjusted EBITDA removes the impact of change in fair value of contingent consideration for the quarters ended March 31, 2015 and 2014 and acquisition costs for the quarter ended March 31, 2015. Adjusted EBITDA and the resulting change in ROIC is shown retrospectively.

(b) Acquisition costs are nondeductible for tax purposes.

(c) Average funded debt is calculated as the average daily amounts outstanding on our current and long-term interest-bearing debt.

Results of Operations

Currency

We make references to "constant currency," a non-GAAP performance measure that excludes the foreign exchange rate impact from fluctuations in the weighted-average foreign exchange rates between reporting periods. Constant currency is calculated by translating current period results from currencies other than the U.S. dollar using the comparable weighted-average foreign exchange rates from the prior year period. This information is provided to view financial results without the impact of fluctuations in foreign currency rates, thereby enhancing comparability between reporting periods.

Net Sales

The Company has two reportable segments, which are based on technologies. The following tables summarize the Company's net sales results by technology segment and by geographic location for the quarters ended March 31, 2015 and 2014, respectively:

Net Sales by Segment:	Quarter ended March 31,			
	2015	2014	\$ Change	% Change
	(in thousands)			
Worldwide Barcode & Security	\$ 422,061	\$ 455,822	\$ (33,761)	(7.4)%
Worldwide Communications & Services	341,142	227,176	113,966	50.2 %
Total net sales	\$ 763,203	\$ 682,998	\$ 80,205	11.7 %

	Nine Months ended March 31,			
	2015	2014	\$ Change	% Change
	(in thousands)			
Worldwide Barcode & Security	\$ 1,422,793	\$ 1,382,672	\$ 40,121	2.9 %
Worldwide Communications & Services	939,148	772,848	166,300	21.5 %
Total net sales	\$ 2,361,941	\$ 2,155,520	\$ 206,421	9.6 %

Worldwide Barcode & Security

The Barcode & Security distribution segment consists of sales to technology resellers in our ScanSource POS & Barcode business units in North America, Europe, Brazil and Latin America and our ScanSource Security business unit in North America. Sales for the Barcode & Security distribution segment decreased \$33.8 million and increased \$40.1 million, compared to the prior year quarter and nine month period, respectively. On a constant currency basis, net sales for the Barcode & Security distribution segment decreased \$9.0 million, which represents a 2.0% decrease compared to the prior year quarter. Compared to the prior year nine month period, on a constant currency basis, net sales increased \$79.6 million, which represents a 5.8% increase. The decrease in Barcode & Security sales for the current quarter as compared to the prior year is primarily due to a decline in big deals across several business units and translation of foreign currency denominated sales in our international operations due to a significant change in the foreign currency exchange rates of the U.S. dollar versus the euro and the Brazilian real. The increase in Barcode & Security sales for the nine month period as compared to the prior year period is primarily due to increased big deals in the first and second quarters for our North America and Europe POS & Barcode and Security businesses, partially offset by unfavorable foreign exchange rate variances.

Worldwide Communications & Services

The Communications & Services distribution segment consists of sales to technology resellers in our ScanSource Communications business units in North America, Europe and Brazil, Imago ScanSource in Europe, ScanSource Catalyst in North America, and ScanSource Services Group. Sales for the Communications & Services segment increased \$114.0 million and \$166.3 million compared to the prior year quarter and nine month period, respectively. On a constant currency basis, net sales for the Communications & Services distribution segment increased \$117.1 million and \$170.8 million, which represents a 51.5% and 22.1% increase compared to the prior year quarter and nine month period, respectively. The increase in Communications & Services sales for the current quarter and nine month period compared to the prior year is primarily due to the inclusion of Imago ScanSource and Network1 sales, which we acquired in September 2014 and January 2015, respectively. In addition, we had year-over-year growth in our North America Communications and Catalyst businesses.

<i>Net Sales by Geography:</i>	Quarter ended March 31,			
	2015	2014	\$ Change	% Change
	(in thousands)			
North America (U.S. and Canada)	\$ 534,742	\$ 498,773	\$ 35,969	7.2%
International	228,461	184,225	44,236	24.0%
Total net sales	\$ 763,203	\$ 682,998	\$ 80,205	11.7%

	Nine Months ended March 31,			
	2015	2014	\$ Change	% Change
	(in thousands)			
North America (U.S. and Canada)	\$ 1,717,600	\$ 1,602,202	\$ 115,398	7.2%
International	644,341	553,318	91,023	16.5%
Total net sales	\$ 2,361,941	\$ 2,155,520	\$ 206,421	9.6%

Gross Profit

The following table summarizes the Company's gross profit for the quarters ended March 31, 2015 and 2014, respectively:

	Quarter ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	(in thousands)					
Worldwide Barcode & Security	\$ 38,738	\$ 43,031	\$ (4,293)	(10.0)%	9.2%	9.4%
Worldwide Communications & Services	41,278	30,320	10,958	36.1 %	12.1 %	13.3%
Gross profit	\$ 80,016	\$ 73,351	\$ 6,665	9.1 %	10.5%	10.7%

	Nine Months ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	(in thousands)					
Worldwide Barcode & Security	\$ 123,640	\$ 126,512	\$ (2,872)	(2.3)%	8.7%	9.1%
Worldwide Communications & Services	112,133	100,594	11,539	11.5 %	11.9%	13.0%
Gross profit	\$ 235,773	\$ 227,106	\$ 8,667	3.8 %	10.0%	10.5%

Worldwide Barcode & Security

Gross profit dollars and gross profit margin decreased for the Barcode & Security distribution segment for the quarter and nine months ended March 31, 2015 compared to the prior year. The decrease in gross profit margin for the current quarter as compared to the prior year is primarily due to a less favorable sales mix and a less favorable mix of international business due to foreign currency translation. The decrease in gross profit margin for the nine month period as compared to the prior year period is primarily due to a less favorable sales mix, driven by an increase in big deals with lower gross margins.

Worldwide Communications & Services

In the Communications & Services distribution segment, gross profit dollars increased, however, gross profit margin decreased for the quarter and nine months ended March 31, 2015, compared to the prior year. The decrease in gross profit margin for the current quarter as compared to the prior year is primarily driven by a less favorable sales mix of lower margin products. The decrease in gross profit margin for the nine month period as compared to the prior year is primarily due to a less favorable sales mix and lower vendor program recognition.

Operating Expenses

The following table summarizes our operating expenses for the quarters and nine months ended March 31, 2015 and 2014, respectively:

	Quarter ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Selling, general and administrative expenses	\$ 58,235	\$ 46,705	\$ 11,530	24.7 %	7.6%	6.8%
Change in fair value of contingent consideration	285	981	(696)	(70.9)%	0.0%	0.1%
Operating expenses	<u>\$ 58,520</u>	<u>\$ 47,686</u>	<u>\$ 10,834</u>	<u>22.7 %</u>	<u>7.7%</u>	<u>7.0%</u>

	Nine Months ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Selling, general and administrative expenses	\$ 158,047	\$ 143,541	\$ 14,506	10.1 %	6.7%	6.7%
Change in fair value of contingent consideration	1,262	2,218	(956)	(43.1)%	0.1%	0.1%
Operating expenses	<u>\$ 159,309</u>	<u>\$ 145,759</u>	<u>\$ 13,550</u>	<u>9.3 %</u>	<u>6.7%</u>	<u>6.8%</u>

Selling, general and administrative expenses ("SG&A") increased \$11.5 million and \$14.5 million for the quarter and nine months ended March 31, 2015. For the quarter ended March 31, 2015, the increase in SG&A compared to the prior quarter is primarily due to additional SG&A for the newly acquired Imago ScanSource and Network1 businesses, as well as increased expenses related to our ERP implementation. For the nine months ended March 31, 2015, the increase in SG&A compared to the prior period is primarily due to increased employee-related expenses and additional SG&A for the newly acquired Imago ScanSource and Network1, partially offset by a reduction in bad debt expense. The Company had a credit for bad debt expense for the nine month period due to improved accounts receivable collections and reduction of specific reserves.

We present changes in fair value of the contingent consideration owed to the former shareholders of CDC, Imago ScanSource and Network1 as a separate line item in operating expenses. In the current quarter and nine month period, we have recorded fair value adjustment losses of \$0.3 million and \$1.3 million, respectively. These losses are primarily the result of the recurring amortization of the unrecognized fair value discount, changes in actual results, and changes in the probability assumptions of future achievable results.

Operating Income

The following table summarizes our operating income for the quarters and nine months ended March 31, 2015 and 2014, respectively:

	Quarter ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Worldwide Barcode & Security	\$ 10,327	\$ 13,820	\$ (3,493)	(25.3)%	2.4%	3.0%
Worldwide Communications & Services	11,461	11,845	(384)	(3.2)%	3.4%	5.2%
Corporate	(292)	—	(292)	nm*	nm*	—%
Operating income	<u>\$ 21,496</u>	<u>\$ 25,665</u>	<u>\$ (4,169)</u>	<u>(16.2)%</u>	<u>2.8%</u>	<u>3.8%</u>

*nm - percentages are not meaningful

	Nine Months ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Worldwide Barcode & Security	\$ 36,444	\$ 38,734	\$ (2,290)	(5.9)%	2.6%	2.8%
Worldwide Communications & Services	43,136	42,613	523	1.2 %	4.6%	5.5%
Corporate	(3,116)	—	(3,116)	nm*	nm*	—%
Operating income	<u>\$ 76,464</u>	<u>\$ 81,347</u>	<u>\$ (4,883)</u>	<u>(6.0)%</u>	<u>3.2%</u>	<u>3.8%</u>

Worldwide Barcode & Security

For the Barcode & Security distribution segment, operating income and operating margin decreased for the quarter and nine months ended March 31, 2015 compared to the prior year periods. The decrease in operating income and margin for the quarter ended March 31, 2015 is largely due to a combination of lower sales volume and a lower gross profit margin. The decrease in operating income and margin for the nine months ended March 31, 2015 is primarily due to a decrease in gross profit margin, partially offset by a credit in bad debt expense.

Worldwide Communications & Services

For the Communications & Services distribution segment, operating income and operating margin decreased for the quarter ended March 31, 2015 compared to the prior year quarter, primarily due to a decrease in gross profit margin, coupled with an increase in employee-related operating expenses, which are a result of the new employees gained through acquisitions.

Operating income increased slightly and operating margin decreased for the nine month period ended March 31, 2015, as compared to the prior period. Operating margin decreased for the nine month period primarily due to a decrease in gross profit margin and increases in employee-related operating expenses, previously described, partially offset by a credit in bad debt expense.

Corporate

Corporate incurred a \$0.3 million and \$3.1 million expense relating to acquisition costs incurred during the quarter and nine months ended March 31, 2015.

Total Other Expense (Income)

The following table summarizes our total other (income) expense for the quarters and nine months ended March 31, 2015 and 2014, respectively:

	Quarter ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Interest expense	\$ 891	\$ 217	\$ 674	310.6 %	0.1 %	0.0 %
Interest income	(731)	(545)	(186)	34.1 %	(0.1)%	(0.1)%
Net foreign exchange (gains) losses	1,626	57	1,569	2,752.6 %	0.2 %	0.0 %
Other, net	(111)	(44)	(67)	152.3 %	(0.0)%	(0.0)%
Total other (income) expense, net	<u>\$ 1,675</u>	<u>\$ (315)</u>	<u>\$ 1,990</u>	<u>(631.7)%</u>	<u>0.2 %</u>	<u>(0.0)%</u>

	Nine Months ended March 31,				% of Net Sales March 31,	
	2015	2014	\$ Change	% Change	2015	2014
	<i>(in thousands)</i>					
Interest expense	\$ 1,288	\$ 698	\$ 590	84.5 %	0.1 %	0.0 %
Interest income	(2,057)	(1,644)	(413)	25.1 %	(0.1)%	(0.1)%
Net foreign exchange (gains) losses	2,606	326	2,280	699.4 %	0.1 %	0.0 %
Other, net	(368)	(261)	(107)	41.0 %	(0.0)%	(0.0)%
Total other (income) expense, net	\$ 1,469	\$ (881)	\$ 2,350	(266.7)%	0.1 %	(0.0)%

Interest expense reflects interest incurred on borrowings and cross currency swap agreements, non-utilization fees from the Company's revolving credit facility, amortization of debt issuance costs, offset by capitalized interest on ERP project costs in the quarter and nine months ended March 31, 2015. Interest expense increased principally from the January 2015 addition of Network1 borrowings totaling \$34.7 million, of which \$28.3 million was repaid during the quarter ended March 31, 2015.

Interest income for the quarter and nine months ended March 31, 2015 was \$0.7 million and \$2.1 million, respectively, and includes interest income generated on longer-term interest bearing receivables and interest earned on cash and cash equivalents.

Net foreign exchange losses consist of foreign currency transactional and functional currency re-measurements, offset by net foreign currency exchange contract gains and losses. Foreign exchange gains and losses are generated from fluctuations in the value of the British pound versus the euro, the British pound versus the U.S. dollar, the U.S. dollar versus the euro, the U.S. dollar versus the Brazilian real, the Canadian dollar versus the U.S. dollar and other currencies versus the U.S. dollar. While we utilize foreign exchange contracts and debt in non-functional currencies to hedge foreign currency exposure, our foreign exchange policy prohibits the use of derivative financial instruments for speculative transactions. For the quarter and nine months ended March 31, 2015, the Company's net foreign exchange losses increased over the prior year from significant changes in foreign currency exchange rates, partially offset by the use of foreign exchange forward contracts to hedge against currency exposures. In addition, the increase includes the higher costs of foreign exchange hedging for Network1, primarily related to the hedging of U.S. dollar-denominated accounts payable.

Provision for Income Taxes

For the quarter and nine months ended March 31, 2015, income tax expense was \$6.9 million and \$26.0 million reflecting an effective tax rate of 34.7% and 34.7%, respectively. The effective tax rate for the quarter and nine months ended March 31, 2014 was 34.8% and 33.5%, respectively. The decrease in the effective tax rate from the prior year quarter is primarily due to a change in the geographical mix of income. The increase in the effective tax rate from the prior year nine month period is primarily due to the recognition of discrete items in the prior year and the impact of non-deductible acquisition costs in the current year, partially offset by a change in the geographical mix of income. Our estimated annual effective tax rate range for the full fiscal year is 34.5% to 35%.

Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operations and borrowings under the \$300 million revolving credit facility. As a distribution company, our business requires significant investment in working capital, particularly accounts receivable and inventory, partially financed through our accounts payable to vendors, cash generated from operations and revolving lines of credit. In general, as our sales volumes increase, our net investment in working capital typically increases, which typically results in decreased cash flow from operating activities. Conversely, when sales volumes decrease, our net investment in working capital typically decreases, which typically results in increased cash flow from operating activities.

Our cash and cash equivalents balance totaled \$93.6 million at March 31, 2015, compared to \$194.9 million at June 30, 2014, including \$37.8 million and \$39.7 million held outside of the United States at March 31, 2015 and June 30, 2014, respectively. The decrease in cash and cash equivalents is primarily from cash used in the purchases of Imago ScanSource and Network1 and cash used to fund the Company's new Enterprise Resource Planning ("ERP") system implementation. Checks released but not yet cleared in the amounts of \$47.9 million and \$84.1 million are included in accounts payable as of March 31, 2015 and June 30, 2014, respectively.

We conduct business in many locations throughout the world where we generate and use cash. The Company provides for U.S. income taxes for the earnings of its Canadian subsidiary. The Company does not provide for U.S. income taxes for undistributed earnings from all other geographies that are considered to be retained indefinitely for reinvestment. If these funds were distributed in the operations of the United States, we would be required to record and pay significant additional foreign withholding taxes and additional U.S. federal income taxes upon repatriation of these funds.

Our net investment in working capital has decreased to \$653.4 million at March 31, 2015 from \$715.9 million at June 30, 2014 and \$694.5 million at March 31, 2014. Net working capital has decreased \$62.5 million since June 30, 2014, principally from a decrease in cash, partially offset by higher accounts receivable and lower accounts payable. Our net investment in working capital is affected by several factors such as fluctuations in sales volume, net income, timing of collections from customers, increases and decreases to inventory levels, payments to vendors, as well as cash generated or used by other financing and investing activities.

	Nine months ended	
	March 31, 2015	March 31, 2014
Cash provided by (used in):		
Operating activities	\$ 27,137	\$ 32,670
Investing activities	(79,594)	(6,785)
Financing activities	(36,166)	8,873
Effect of exchange rate change on cash and cash equivalents	(12,650)	640
Increase (decrease) in cash and cash equivalents	\$ (101,273)	\$ 35,398

Net cash provided by operating activities was \$27.1 million for the nine months ended March 31, 2015, decreasing \$5.5 million from the same period in the prior year primarily from lower net income. Operating cash flow for the nine months ended March 31, 2015 is primarily attributable to net income, decreases in accounts receivable and inventory, partially offset by decreases in account payable, excluding the impact of the assets and liabilities initially acquired from Imago ScanSource and Network1.

The number of days sales outstanding ("DSO") was 57 days at March 31, 2015, compared to 55 days at June 30, 2014 and March 31, 2014. Inventory turned 5.4 times during the third quarter of fiscal year 2015 versus 5.8 and 5.1 times in the sequential and prior year quarters, respectively.

Cash used in investing activities for the nine months ended March 31, 2015 was \$79.6 million, compared to \$6.8 million used in the prior year period. The increase in cash used in investing activities is due to the acquisition of the Imago ScanSource and Network1 businesses and capital expenditures for the Company's new ERP system.

In December 2013, we retained SAP for the software platform and implementation consulting services for a new ERP system. The Company's European operations, excluding Imago ScanSource, began utilizing the new ERP system during the third quarter of the current fiscal year. The Company is currently working on the implementation of the new ERP platform in North America and expects additional costs associated with the ERP project to be included in SG&A. Management expects capital spending for fiscal 2015 to range from \$20 million to \$21 million, primarily related to capital expenditures already incurred for the ERP system.

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For the nine months ended March 31, 2015, cash used in financing activities totaled to \$36.2 million compared to cash provided by financing activities of \$8.9 million in the prior year period. The increase in cash used in financing activities was primarily from the repayments on short-term borrowings of Imago ScanSource and Network1, a contingent consideration payment to former shareholders of CDC and repurchases of common stock.

The Company assumed net debt from Network1 of \$34.7 million as of January 13, 2014, date of acquisition. During the quarter ended March 31, 2015, we repaid \$28.3 million. The remaining outstanding borrowings as of March 31, 2015 totaled \$6.4 million, of which \$5.1 million is classified as current.

In August 2014, our Board of Directors authorized a three-year \$120 million share repurchase program. The Company repurchased \$2.7 million of shares during the nine months ended March 31, 2015.

The Company has a \$300 million multi-currency senior secured revolving credit facility that was scheduled to mature on October 11, 2016. On November 6, 2013, the Company entered into an amendment of this credit facility ("Amended Credit Agreement") with JP Morgan Chase Bank, N.A, as administrative agent, and a syndicate of banks to extend its maturity to November 6, 2018. The Amended Credit Agreement allows for the issuance of up to \$50 million for letters of credit and has a \$150 million accordion feature that allows the Company to increase the availability to \$450 million, subject to obtaining additional credit commitments for the lenders participating in the increase.

At our option, loans denominated in U.S. dollars under the Amended Credit Agreement, other than swingline loans, bear interest at a rate equal to a spread over the London Interbank Offered Rate ("LIBOR") or alternate base rate depending upon the Company's ratio of total debt (excluding accounts payable and accrued liabilities) to EBITDA, measured as of the end of the most recent year or quarter, as applicable, for which financial statements have been delivered to the Lenders (the "Leverage Ratio"). This spread ranges from 1.00% to 2.25% for LIBOR-based loans and 0.00% to 1.25% for alternate base rate loans. Borrowings under the Amended Credit Agreement are guaranteed by substantially all of the domestic assets of the Company as well as certain foreign subsidiaries determined to be material under the Amended Credit Agreement and a pledge of up to 65% of capital stock or other equity interest in each Guarantor (as defined in the Amended Credit Agreement). We were in compliance with all covenants under the credit facility as of March 31, 2015.

There were no outstanding borrowings on our \$300 million revolving credit facility as of March 31, 2015 and June 30, 2014.

On a gross basis, we borrowed and repaid \$93.6 million on our Revolving Credit Facility in the nine months ended March 31, 2015. In the prior year period, we had no borrowing and repayments. The average daily balance during the nine month period ended March 31, 2015 and 2014 was \$2.2 million and \$0.0 million, respectively. There were no standby letters of credits issued and outstanding as of March 31, 2015 on the revolving credit facility, leaving \$300 million available for additional borrowings.

Imago ScanSource, a new subsidiary of the Company, has multi-currency invoice discounting credit facilities secured by the subsidiary's accounts receivable for its operations based in the United Kingdom and France. The invoice discounting facilities allow for the issuance of funds up to 85% of the amount of each invoice processed, subject to limits by currency of £4.1 million, €4.1 million, and \$0.7 million. Borrowings under the invoice discounting facilities bear interest at a base rate determined by currency, plus a spread of 1.85%. The base rate is the United Kingdom base rate published by the Bank of England for GBP-based borrowings, 30-day EUROLIBOR for Euro-based borrowings, and the Lloyds Bank daily USD published rate for the USD-based borrowings. Additionally, the Company is assessed an annual commitment fee of less than £0.1 million. There were no outstanding balances at March 31, 2015.

On April 15, 2011, the Company, through its wholly-owned subsidiary, ScanSource do Brasil Participações LTDA, completed its acquisition of all of the shares of CDC, pursuant to the Share Purchase and Sale Agreement dated April 7, 2011. The purchase price was paid with an initial payment of \$36.2 million, net of cash acquired, assumption of working capital payables and debt, and variable annual payments through October 2015 based on CDC's annual financial results. The Company has made four payments to the former shareholders. As of March 31, 2015, we have \$4.2 million recorded for the continuing earnout obligation, all of which is classified as current. The future earnout payment will be funded by cash on hand and our existing revolving credit facility.

On September 19, 2014, the Company, through a wholly-owned subsidiary, completed its acquisition of 100% of the shares of Imago ScanSource, pursuant to the Share Purchase Agreement. The purchase price was structured with an initial payment of \$37.4 million, plus two additional annual cash installments for the twelve months ending September 30, 2015 and 2016, based on the financial performance of Imago ScanSource. The Company acquired \$1.9 million of cash during the acquisition, resulting in net \$35.5 million cash paid for Imago ScanSource. As of March 31, 2015, we have \$4.9 million recorded for the earnout obligation,

of which \$2.3 million is classified as current. Future earnout payments will be funded by cash on hand and our existing revolving credit facility.

On January 13, 2015, the Company, through a wholly-owned subsidiary, acquired 100% of the shares of Intersmart Comércio Importação Exportação de Equipamentos Eletrônicos, S.A., a corporation organized under the laws of the Federative Republic of Brazil, and its related entities (collectively “Network1”), pursuant to the Share Purchase and Sale Agreement. The Company structured the purchase transaction with an initial cash payment of approximately \$29.1 million, plus additional annual cash installments based on EBITDA over the next four years, commencing with the period ending June 30, 2015. The Company acquired \$4.8 million of cash during the acquisition, resulting in \$24.2 million net cash paid for Network1. As of March 31, 2015, we have \$22.3 million recorded for the earnout obligation, of which \$3.5 million is classified as current. Future earnout payments will be funded by cash on hand and our existing revolving credit facility.

We believe that our existing sources of liquidity, including cash resources and cash provided by operating activities, supplemented as necessary with funds under our credit agreements, will provide sufficient resources to meet the present and future working capital and cash requirements for at least the next twelve months.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future affect or change on the company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The term "off-balance sheet arrangement" generally means any transaction, agreement or other contractual arrangement to which an entity unconsolidated with the company is a party, under which the company has (i) any obligation arising under a guarantee contract, derivative instrument or variable interest; or (ii) a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.

In addition to the contractual obligations and commitments disclosed in our Annual Report on the Form 10-K, as of August 28, 2014, the Company entered into additional contingent consideration commitments for the earnout obligations pertaining to the Imago and Network1 acquisitions. See Notes 8 and 12 of the Company's Notes to Consolidated Financial Statements herein.

Accounting Standards Recently Issued

In May 2014, the FASB issued a comprehensive new revenue recognition standard for contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of this standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, the standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. This guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early application is prohibited. The standard permits the use of either the retrospective or cumulative effect transition method. This guidance will be applicable to the Company for the fiscal year beginning July 1, 2017, which is the first quarter of fiscal year 2018. The Company is currently evaluating the impact on its consolidated financial statements upon the adoption of this new standard.

Critical Accounting Policies and Estimates

Critical accounting policies are those that are important to our financial condition and require management's most difficult, subjective or complex judgments. Different amounts would be reported under different operating conditions or under alternative assumptions. We have evaluated the accounting policies used in the preparation of the consolidated financial statements and related notes and believe those policies to be reasonable and appropriate. See Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended June 30, 2014 for a complete listing of our significant accounting policies.

Goodwill

Goodwill is not amortized but is tested annually for impairment at a reporting unit level. Additionally, goodwill is tested for impairment on an interim basis if at any time facts and circumstances indicate that an impairment may have occurred.

As discussed in Item 7 of the Company's 2014 Annual Report on Form 10-K under Critical Accounting Policies, we performed our annual goodwill impairment test as of April 30, 2014 and found that the estimated fair value of the Latin America reporting unit exceeded its carrying values by 10.2%, a smaller margin than the Company's other goodwill reporting units. As of March 31, 2015 the Company has goodwill associated with ScanSource Latin America of \$4.0 million.

We monitor results of these reporting units on a quarterly basis, as not meeting estimated expectations or changes to the projected future results of their operations could result in a future impairment of goodwill for these reporting entities. Based on current projected future results, we do not believe there is a more likely than not expectation that a goodwill impairment exists.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's principal exposure to changes in financial market conditions in the normal course of its business is a result of its selective use of bank debt and transacting business in foreign currencies in connection with its foreign operations.

Interest Rate Risk

The Company is exposed to changes in interest rates primarily as a result of its borrowing activities, which include revolving credit facilities with a group of banks used to maintain liquidity and fund the Company's business operations. The nature and amount of the Company's debt may vary as a result of future business requirements, market conditions and other factors. A hypothetical 100 basis point increase or decrease in interest rates on borrowings on the Company's revolving credit facility, variable rate long-term debt and subsidiary invoice discounting facilities for the quarter ended March 31, 2015 would have resulted in less than a \$0.1 million increase or decrease, respectively, in pre-tax income for the period.

The Company evaluates its interest rate risk and may use interest rate swaps to mitigate the risk of interest rate fluctuations associated with the Company's current and long-term debt. At March 31, 2015, the Company inherited cross currency swaps related to fixed rate debt acquired from Network1. These swaps involve the exchange of principal and fixed interest receipts of U.S. dollar-denominated debt held by Network1 for principal and variable interest payments equal to the Average One-Day Interbank Deposit Rate ("CDI" rate), plus an applicable spread, in Brazilian reais. The Company's use of derivative instruments have the potential to expose the Company to certain market risks including the possibility of (1) the Company's hedging activities not being as effective as anticipated in reducing the volatility of the Company's cash flows, (2) the counterparty not performing its obligations under the applicable hedging arrangement, (3) the hedging arrangement being imperfect or ineffective, or (4) the terms of the swap or associated debt changing. The Company seeks to lessen such risks by having established a policy to identify, control, and manage market risks which may arise from changes in interest rates, as well as limiting its counterparties to major financial institutions.

Foreign Currency Exchange Rate Risk

The Company is exposed to foreign currency risks that arise from its foreign operations in Canada, Latin America, Brazil and Europe. These risks include transactions denominated in non-functional currencies and intercompany loans with foreign subsidiaries. In the normal course of the business, foreign exchange risk is managed by balance sheet netting of exposures, as well as the use of foreign currency forward contracts to hedge these exposures. In addition, exchange rate fluctuations may cause our international results to fluctuate significantly when translated into U.S. dollars. These risks may change over time as business practices evolve and could have a material impact on the Company's financial results in the future.

The Company's senior management has approved a foreign exchange hedging policy to reduce foreign currency exposure. The Company's policy is to utilize financial instruments to reduce risks where internal netting cannot be effectively employed and not to enter into foreign currency derivative instruments for speculative or trading purposes. The Company monitors its risk associated with the volatility of certain foreign currencies against its functional currencies and enters into foreign exchange derivative contracts to minimize short-term currency risks on cash flows. These positions are based upon balance sheet exposures and, in certain foreign currencies, our forecasted purchases and sales. The Company continually evaluates foreign exchange risk and may enter into foreign exchange transactions in accordance with its policy. Actual variances from these forecasted transactions can adversely impact foreign exchange results. Foreign currency gains and losses are included in other expense (income).

The Company has elected not to designate its foreign currency contracts as hedging instruments, and therefore, the instruments are marked-to-market with changes in their values recorded in the consolidated income statement each period. The Company's foreign currencies are primarily British pounds, euros, Mexican pesos, Brazilian reais and Canadian dollars. At March 31, 2015, the fair value of the Company's currency forward contracts outstanding was a net receivable of less than \$0.1 million. The Company does not utilize financial instruments for trading or other speculative purposes.

Item 4. Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the Company's management, including its Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO") and Principal Accounting Officer ("PAO") of the effectiveness of the Company's disclosure controls and procedures as of March 31, 2015. Based on that evaluation, the Company's management, including the CEO, CFO and PAO, concluded that the Company's disclosure controls and procedures are effective as of March 31, 2015. During the quarter and nine months ended March 31, 2015, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

The Company and its subsidiaries are, from time to time, parties to lawsuits arising out of operations. Although there can be no assurance, based upon information known to the Company, the Company believes that any liability resulting from an adverse determination of such lawsuits would not have a material adverse effect on the Company's financial condition or results of operations.

Item 1A. Risk Factors

In addition to the risk factors discussed in our other reports and statements that we file with the SEC, you should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended June 30, 2014, which could materially affect our business, financial condition and/or future operating results. Furthermore, we are subjected to the following risk.

Vendor consolidation - Vendor consolidation that could lead to changes in the nature and terms of relationships with our major vendors could adversely affect our business, results of operations and financial condition.

A significant amount of our inventory purchases are made from a limited number of vendors. Our reliance on these vendors leaves us vulnerable to having an inadequate supply of required products, price increases, late deliveries, and poor product quality. Like other distributors in our industry, we occasionally experience supplier shortages and are unable to purchase our desired volume of products. Increasingly, our vendors are combining and merging together and thus our vendors are becoming more consolidated. As a result, if we are unable to maintain an adequate supply of products, or if vendors do not regularly invest in, introduce to us, and/or make new products available to us for distribution, our revenue and gross profit could suffer considerably. Finally, we cannot provide any assurance that particular products, or product lines, will be available to us, or available in quantities sufficient to meet customer demand. Any limits to product access could materially and adversely affect our business and results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the third quarter, the Company repurchased shares of its common stock as follows:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of the publicly announced plan or program	Approximate dollar value of shares that may yet be purchased under the plan or program
January 1, 2015 through January 31, 2015	—	—	—	—
February 1, 2015 through February 28, 2015	11,357	\$ 35.58	11,357	\$ 119,595,921
March 1, 2015 through March 31, 2015	58,608	\$ 39.08	58,608	\$ 117,305,833
Total	69,965	\$ 38.51	69,965	\$ 117,305,833

On August 21, 2014, the Company announced a Board of Directors authorization to repurchase shares up to \$120 million of the Company's common stock over three years.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
2.1	Share Purchase and Sale Agreement between and among CDC Brasil Distribuidora de Tecnologias Especiais LTDA and Global Data Network LLP, Rafael Nassar Paloni, Joao Ricardo de Toledo, and Walter Haddad Uzum as Sellers dated January 8, 2015, incorporated by reference to Exhibit 2.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on February 3, 2015.
10.1+	Distributor Agreement Addendum between Avaya Inc. and ScanSource, Inc. dba ScanSource Catalyst.
10.2+	Payment Terms Offer to Distributor Agreement between Avaya Inc. and ScanSource, Inc. dba ScanSource Catalyst, effective March 16, 2015.
31.1	Certification of the Chief Executive Officer, Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer, Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from our Quarterly Report on Form 10-Q for the quarter and nine months ended March 31, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets as of March 31, 2015 and June 30, 2014; (ii) the Condensed Consolidated Income Statement for the quarters and nine months ended March 31, 2015 and 2014; (iii) the Condensed Consolidated Statements of Comprehensive Income (Loss) for the quarters and nine months ended March 31, 2015 and 2014; (iv) the Condensed Consolidated Statements of Cash Flows for the nine months ended March 31, 2015 and 2014; and (v) the notes to the Condensed Consolidated Financial Statements.
+	Confidential treatment has been requested with respect to certain portions of this Exhibit, which portions have been omitted and filed separately with the Commission as part of an application for confidential treatment.

SIGNATURES

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

ScanSource, Inc.

/s/ MICHAEL L. BAUR

Michael L. Baur
Chief Executive Officer
(Principal Executive Officer)

Date: May 5, 2015

/s/ CHARLES A. MATHIS

Charles A. Mathis
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: May 5, 2015

/s/ GERALD LYONS

Gerald Lyons
Senior Vice President of Finance and Principal Accounting Officer
(Principal Accounting Officer)

Date: May 5, 2015

EXHIBIT INDEX TO QUARTERLY REPORT ON FORM 10-Q

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+	Confidential treatment has been requested with respect to certain portions of this Exhibit, which portions have been omitted and filed separately with the Commission as part of an application for confidential treatment.

REDACTED – OMITTED MATERIAL HAS BEEN SEPARATELY FILED WITH THE COMMISSION PURSUANT TO RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, AND IS DENOTED HEREIN BY *****



DISTRIBUTOR HOSTED IP OFFICE INTERIM ADDENDUM

DISTRIBUTOR AGREEMENT

CONTRACT NUMBER: AVDIST1-021002

This Partner Hosted IP Office Interim Addendum is made by and between **Avaya Inc.**, with an address at 4655 Great American Parkway, Santa Clara, California 95054 ("**Avaya**") and **ScanSource, Inc. dba ScanSource Catalyst**, having an office at 6 Logue Court, Greenville, South Carolina 29615 ("**Distributor**").

WHEREAS:

- (A) Avaya and Distributor are parties to a certain Distributor Agreement, contract number AVDIST1-021002, effective August 16, 2002, as amended (the "**Agreement**");
- (B) Avaya and Distributor desire to implement and, where applicable, modify the terms and conditions of the Agreement, pursuant to which Distributor may purchase from Avaya, on a time-bound subscription basis, certain Avaya IP Office Software licenses and related IP Office Support Services ("**IPOSS**") in order to provide Distributor's Subscription Services to its Resellers in the Territory using the Software (as defined below in Section 1 of this Addendum) located and hosted in Distributor's (or Distributor's subcontractor's) data center, as described in more detail in this Addendum and Exhibit A;
- (C) The Agreement is incorporated in this Addendum by reference, except where specifically stated to the contrary. Unless the context requires otherwise, this Addendum together with the Agreement, incorporated by reference and all Exhibits and Attachments to either this Addendum or the Agreement, is referred to collectively as the "**Addendum**."

The following Exhibits are incorporated by reference into this Addendum:

- Exhibit A – Distributor Hosted IP Office Interim Offer and Pricing
- Exhibit B – Sample Monthly Fee Calculation (for illustration purposes only)

NOW THEREFORE, Avaya and Distributor agree as follows:

1. DEFINITIONS

Capitalized terms not defined in this Addendum will have the meanings given them in the Agreement. Any definitions included in this Addendum apply solely for purposes of this Addendum. The following terms will have the meanings assigned to them in this Section:

- 1.1. "Addendum Effective Date"** means the effective date of this Addendum, which is the date that the last party signs this Addendum.
- 1.2. "Channel Policies"** means all the Avaya policies and programs applicable to Distributor or Resellers and available on Avaya Partner Portal (<https://www.avaya.com/salesportal> or successor site), as amended by Avaya from time to time at Avaya's discretion upon prior written notice to Distributor.
- 1.3. "Customers"** means End Users purchasing Subscription Services from Reseller solely for their internal business use and not for resale, sublease, or sublicense.
- 1.4. "EULA"** refers to the Avaya End User License as defined under the Agreement.
- 1.5. "Hardware"** means the standard Avaya hardware products that Distributor may order or Avaya delivers under the Agreement.
- 1.6. "Helpdesk Support"** means help desk support provided by Distributor to its Resellers and, if applicable, Customers, including in particular the logging of calls, managing the relations with Resellers and answering initial inquiries including technical questions about the Hosted IP Office Infrastructure and Subscription Services.
- 1.7. "Hosted IP Office Infrastructure"** means the Software, hardware, Third Party Products and/or their combination hosted by Distributor in its (or its subcontractors', subject to Section 2.8 of this Addendum (Subcontractors)) data center in the Territory for the purpose of providing Distributor's Subscription Services to Resellers for further resale by Resellers to Customers.

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- 1.8. **"Incident"** means a failure of Software to conform in all material respects to the manufacturer's specifications that were currently applicable when that Software was licensed to Distributor.
- 1.9. **"Initial Order"** means the first order for Software licenses for a new Software Instance assigned to a Customer, including the initial number and type of Users, as described in more detail in Exhibit A.
- 1.10. **"Instance"** means a single copy of the Software executing at a particular time: (i) on one physical machine; or (ii) on one deployed software virtual machine ("VM") or similar deployment. Each Instance of the Software generates a unique System ID.
- 1.11. **"Order"** means, as the context requires, the Initial Order or any Subsequent Order or both.
- 1.12. **"Order Term"** means the term during which Distributor may, subject to Section 12 (Term and Termination), use Software and Support Services ordered under individual Orders, and which in no event may exceed the term of this Addendum.
- 1.13. **"Product Authorization Requirements"** means the requirements to ensure that Avaya Resellers, distributors and service providers have the capabilities to successfully sell, configure, design, install and support Products, and are defined for each Product in various areas, such as, without limitation, specific knowledge of Products or technologies, customer support capability (including an inventory of a minimum amount of critical spare parts), sales capability, implementation, installation and maintenance capability, and End User training.
- 1.14. **"Reseller Agreement"** means, subject to Section 2.2, an agreement between Distributor and Reseller under which Distributor provides Subscription Services to Reseller for further resale of Subscription Services to Customers.
- 1.15. **"Service Description"** means the applicable Avaya service agreement supplement or service description document, as the case may be, then current as of the date of Avaya's acceptance of the applicable Order under this Addendum and available to Distributor upon request.
- 1.16. **"Software"** means Avaya IP Office "Software" (as defined in the Agreement) that is licensed to Distributor under this Addendum on a subscription basis. Notwithstanding the foregoing, Software, for purposes of this Addendum, is limited to such IP Office Software and does not include other Avaya software.
- 1.17. **"Subscription Services"** means a Distributor-hosted, non-perpetual service by Distributor that is based in part on the Software, and which Distributor makes accessible on a subscription basis to Resellers for further resale by those Resellers to their Customers.
- 1.18. **"Subsequent Order"** means an order issued by Distributor subsequently to the Initial Order for a defined Customer for an increase or decrease of Users for that Customer and their associated System ID. Subsequent Orders must include the unique System ID of a Software Instance hosted for a Customer where an increase or decrease of Users is desired.
- 1.19. **"Support Services"** means the Tier 3 and Tier 4 support Services performed by Avaya under this Addendum to maintain Software, including Incident correction and updates and, if ordered, upgrades, as more fully described in the applicable Service Description and this Addendum. Support Services do not include any installation, implementation, professional or similar services.
- 1.20. **"System ID"** is a 40 character string generated by each unique Instance of the Software.
- 1.21. **"Territory"** means the 50 States of the United States and the District of Columbia.
- 1.22. **"User"** refers to the specific metrics used by Avaya as the basis for the pricing and invoicing for Named User Software licenses (as defined in the EULA) that are ordered by Distributors and described in more detail in Exhibit A. As of the Addendum Effective Date, the types of Users include Telephony Users and Unified Communications (UC) Users of Customers.

2. AUTHORIZATION

- 2.1. **Authorization.** Subject to the terms and conditions of this Addendum and the Channel Policies, Avaya hereby authorizes Distributor to purchase directly from Avaya the non-exclusive, non-transferable, non-sublicensable, limited license to use Software (as defined in this Addendum) and related Support Services, as described in more detail in Exhibit A, required by Distributor to enable the Hosted IP Office Infrastructure for the sole purpose of marketing Distributor's Subscription Services to Resellers in the Territory in order for Resellers to resell those Subscription Services to Customers

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in the Territory. Any Software ordered under this Addendum will be licensed to Distributor on a subscription basis only, against a monthly fee determined in accordance with this Addendum. Support Services will be provided on a subscription basis against a monthly fee and a one-time support initiation fee for each Customer, determined in accordance with this Addendum. This Addendum does not apply to Distributor's purchase of any Hardware from Avaya. Any sale of Hardware will be governed by the terms and conditions of the Agreement. Except as permitted in this Section 2.1, Distributor shall not market Subscription Services or otherwise use the Hosted IP Office Infrastructure or any portions thereof. In particular, Distributor is not authorized to resell Subscription Services or any other Avaya Products or Services directly to Customers. Nothing in this Addendum will be interpreted as authorizing Distributor to resell: (i) a Distributor-branded version of IPOSS; and/or (ii) any Support Services provided by Avaya under this Addendum on a stand-alone basis or otherwise contrary to the authorization expressly granted under this Section 2.1. Avaya reserves the right to modify the conditions of this authorization or revoke it at any time by giving Distributor a *****-day written notice of the de-authorization with the effective date on the last day of the monthly invoicing period.

- 2.2. Resellers.** Prior to providing any Subscription Services to any Reseller, Distributor must first execute a Reseller Agreement with that Reseller implementing all the flow-down related requirements set forth in this Addendum or amend the existing agreement between Distributor and Reseller for that purpose. Subject to Section 8.8 of this Addendum any Reseller to whom Distributor may provide Subscription Services must be an Avaya authorized reseller maintaining all the required Product Authorization Requirements and certifications for the Software as set out by Avaya in the Channel Policies. If Avaya determines that any Subscription Services are provided by Distributors to Resellers who do not have the required Product Authorization Requirements and certifications, it may require Distributor to terminate the Reseller Agreement, or its part applicable to Subscription Services, with a Reseller who does not meet the required criteria. In addition, upon Avaya's request, Distributor shall terminate the Reseller Agreement, or its part applicable to Subscription Services, with a Reseller who has in any way violated the terms of the EULA or has failed to comply with its confidentiality obligations with respect to Avaya's confidential information or has failed to comply with any legal obligations in particular those described in Section 5 of this Addendum (Compliance with Laws). Resellers are only authorized to market and resell Subscription Services provided to them by Distributors to Customers for Customers' internal business purposes. Distributor shall expressly prohibit Resellers under the Reseller Agreement from reselling Subscription Services to any other resellers or distributors of Avaya products or services. *****.
- 2.3. Termination of Reseller Agreements.** In case of termination of a Reseller Agreement for any reason, or its part applicable to Subscription Services, and unless Reseller's Customers are re-allocated to an alternative Reseller within 30 days of such termination, Distributor shall de-activate Software licenses and Software Instances allocated to that Reseller. Notwithstanding the foregoing, Avaya will continue to invoice, and Distributor agrees to pay, for any activated licenses for that Reseller, until such time Avaya has received a Subsequent Order from Distributor requesting Avaya to reduce the number of licenses, accompanied by a reasonable proof that the Software licenses affected have been deactivated by Distributor.
- 2.4. Support Services entitlements.** This Addendum does not authorize Distributor or grant Distributor any rights to purchase any Services from Avaya other than Support Services expressly described in Exhibit A. Any Support Services provided by Avaya to Distributor under this Addendum and any entitlements, tools, rights of access, information, data, access to Avaya's resources and similar items, rights or privileges (collectively, "Services Entitlements") may be used by Distributor solely for purposes of providing Subscription Services to Resellers as described in this Addendum and for no other purpose. Avaya may audit Distributor's compliance with its obligations pertaining to Support Services and Distributor's use of any Services Entitlements in accordance with Section 9 (Audit Rights). If following the audit or otherwise Avaya determines that Distributor uses Services Entitlements outside the scope of this Addendum or for any purpose other than providing Subscription Services to Resellers in accordance with this Addendum it may, without prejudice to any rights and remedies available to Avaya under this Addendum, at law or equity terminate this Addendum for Distributor's material breach if Distributor fails to cure the breach, within a 30 day period after having received a written notice from Avaya requesting the breach be cured. *****.
- 2.5. Restrictions on Resale and Marketing.** Without prior written authorization from Avaya, Distributor shall not market, sell, license or otherwise use the Hosted IP Office Infrastructure or provide Subscription Services outside the Territory. Any such marketing, sale, license or provision may be grounds for termination of this Addendum and/or Agreement subject to Section 21.2 in the Agreement. Except as otherwise expressly provided for in this Addendum, Distributor shall not authorize others to offer, market or otherwise provide Subscription Services to Resellers or Customers in the Territory. Any such authorization will be void and without effect.

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- 2.6. Non-exclusivity.** Avaya expressly reserves the right to engage directly or indirectly, or contract with others, to market, sell, license or otherwise provide subscription or similar services based on the Software and/or any other Products in and outside the Territory.
- 2.7. Publicity Releases.** Except for any announcement intended solely for internal distribution by either party or any disclosure required by legal, accounting or regulatory requirements, or any disclosures made in conjunction with investor relations activities, neither party shall publicize or release any information in connection with this Addendum, or refer to the other party, in any offering, promotion, advertising, web site, presentation, press release/statement, publication or communication of similar nature, except with the prior express written authorization of the other party.
- 2.8. Subcontractors.** Distributor may host the Software from its own or a subcontractor's data center under this Addendum, provided that if Distributor hosts the Software from a subcontractor's data center, then (i) Avaya shall first pre-approve, such pre-approval not to be unreasonably withheld, in writing (email acceptable) such subcontractor; (ii) Distributor shall first enter into an agreement with its subcontractor with applicable terms at least as protective as the terms herein (including, but not limited to, with respect to compliance with the EULA if and to the extent the subcontractor is accessing the Software, and the confidentiality and protection of the Software), and shall reasonably cooperate with Avaya in enforcing the terms of such agreement, and (iii) Distributor shall be fully responsible and liable to Avaya and/or its Affiliates for any harm, damage, liability or injury caused to Avaya or its Affiliates as a result of or in connection with the actions or inactions of Distributor's subcontractor or any breach by the subcontractor of its agreement with Distributor. Distributor shall be fully responsible for the actions or inactions of Distributor's subcontractor as if it were its own actions.

3. ORDERS

- 3.1. Orders.** Avaya will provide Software and Support Services as described in this Addendum, the applicable Service Description and accepted Order. Distributor shall explicitly reference this Addendum and specify: (i) Reseller name; (ii) Customer name; (iii) where applicable, unique System ID assigned to that Customer or Instance of Software; (iv) type and number of Users ordered; and (v) any other details that Avaya may reasonably require, on all its Orders for Software and Support Services under this Addendum.
- 3.2. Order acceptance.** Avaya may reject any Order submitted by Distributor under this Addendum at any time prior to acceptance. Any Order submitted by Distributor will be binding when accepted by Avaya by means of electronic communication or in writing or when Avaya enables Distributor access to the Software in connection with that Order, whichever takes place earlier. Acknowledgment that an Order has been received will not alone constitute acceptance. Avaya will endeavor to confirm Orders within 10 business days. All Orders for Software and Support Services relating to Hosted IP Office Infrastructure will be deemed to incorporate and be subject to the terms and conditions of this Addendum, even when they lack an express reference thereto. All other terms and conditions contained on any order form or other document not expressly referenced in this Agreement will have no effect.
- 3.3. Procedures for Order submission.** Distributor shall submit all Orders to Avaya by email on the Avaya provided or approved order form in accordance with the procedures, in the format and to the address as instructed by Avaya. Distributor shall follow this process for each Initial Order and Subsequent Order. On-line ordering provisions included in the Agreement do not apply to this Addendum.
- 3.4. Support Services initiation.** With respect to Support Services, Distributor shall follow the IPOSS ordering process for initiating Support Services. Along with each Initial Order for Software licenses, Distributor must place a separate IPOSS order directly with Avaya for the associated Customer for initiating Support Services. Distributor shall initiate Support Services in connection with each and every Customer.
- 3.5. Order changes, cancellation and delays.** Order changes, cancellation and delays provisions included in the Agreement do not apply to this Addendum.

4. DISTRIBUTOR RESPONSIBILITIES

- 4.1. Marketing and Sale Efforts.** Distributor shall make commercially reasonable efforts to conduct business in a manner that reflects favorably on the quality image of the Hosted IP Office Infrastructure and Subscription Services and the good name, goodwill and reputation of Avaya, and shall not employ deceptive, misleading or unethical practices detrimental to Avaya, the Hosted IP Office Infrastructure or Subscription Services. Distributor shall conduct business under its corporate name which Distributor shall display prominently in any communications or advertisements to its Resellers. Distributor shall use commercially reasonable efforts to promote, market and expand the provision of Subscription Services in the Territory.

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- 4.2. Competencies and certifications.** Distributor shall comply with applicable competency and certification requirements and shall, at all times, maintain applicable accreditations and certifications, as detailed in the Channel Policies and as applicable to the Avaya-branded Products included in the Hosted IP Office Infrastructure. Without limiting the generality of the foregoing, any personnel involved by Distributor in the deployment or provision of Subscription Services and the deployment, support and maintenance of the Hosted IP Office Infrastructure must have the level of certification and knowledge of IP Office as defined in the Channel Policies and reasonable knowledge of VMware software. Distributor acknowledges and agrees that Support Services provided by Avaya under this Addendum are made available to Distributor providing it complies, at all times, with Avaya's certification credentials and competency requirements applicable to Avaya's IPOSS co-delivery partners. Consequently, Distributor must, at all times during the term of this Addendum: (i) comply with all IPOSS co-delivery certifications and competency requirements; and (ii) obtain and maintain all other applicable certifications and qualifications, as set out in the Channel Policies. Avaya may request Distributor to de-authorize and terminate, with immediate effect, the Reseller Agreement, or its applicable part pertaining to Subscription Services, with a Reseller who does not comply with any of the applicable requirements, and Distributor shall so comply with such request. If Avaya's agreement with a Reseller is terminated, then upon notice to Distributor, Distributor may not continue to resell the Subscription Services to such Reseller. The certification and competency requirements are subject to review and renewal, and may be withdrawn or terminated, by Avaya at any time. Distributor shall be liable to Avaya and its Affiliates for any costs, expenses, liabilities and claims arising from Distributor's delay or failure to include the above requirements in the Reseller Agreement or to terminate the Reseller Agreement.
- 4.3. Setup of IP Office Hosted Infrastructure.** Distributor will be responsible for the architecture, design and configuration definition of the Hosted IP Office Infrastructure and other architectural requirements to accommodate the expected number of Customers in order to properly enable the usage of the Hosted IP Office Infrastructure at the desired capacity level. Avaya will not be responsible for the installation, configuration, provision of SIP trunking and other activities in relation to the delivery, deployment, maintenance and support of the Hosted IP Office Infrastructure. In fulfilling these responsibilities Distributor shall comply with commercially reasonable industry practices and standards with regards to security and quality of service to Resellers and Customers and ensure that Software is optimally deployed and configured relative to Resellers' and Customers' needs. With the exception of Software licenses granted and Support Services purchased by Distributor under this Addendum, and described in Exhibit A, Distributor will be responsible to provide, at its own cost, all Hardware, equipment, software and services as may be necessary for the deployment of Subscription Services using the Hosted IP Office Infrastructure. Avaya manufactured-Hardware is available for purchase from Avaya on an upfront, non-subscription basis under the terms and conditions of the Agreement.
- 4.4. On-boarding.** As between Avaya and Distributor, Distributor will be responsible, at its own cost, for performing all on-boarding activities for each Reseller and their Customer. On-boarding activities include, without limitation, design, installation and configuration of the Hosted IP Office Infrastructure to meet the requirements of each Reseller and their Customer. Software licenses under this Addendum are tied to a unique System ID and may only be used for one Customer at a time. They may not be re-used or re-allocated by Distributor to a different System ID. Prior to on-boarding any Reseller and/or Customer, Distributor shall ensure that any components of the Hosted IP Office Infrastructure, with the exception of Software provided under this Addendum, is in working order in accordance with the applicable manufacturer documentation and specifications. For each Customer, Distributor is responsible for registering with Avaya each Customer's Instance(s) of the Software in accordance with any instructions provided by Avaya, in addition to registering or providing Avaya with any other information reasonably required by Avaya in connection with this Addendum.
- 4.5. Integration into Network Environment.** Distributor is solely responsible for providing at its own cost all facilities, software, equipment, network, trunking and services, other than the Software licenses provided by Avaya under the terms of this Addendum, as necessary to provide Subscription Services using the Hosted IP Office Infrastructure. Distributor is responsible for all costs associated with operating and maintaining such facilities, software and equipment, including without limitation rent, office costs, utilities fees, connectivity charges and all applicable taxes and duties with respect to the same. Except to the extent that Avaya is contracted to perform specific integration services, Distributor will be responsible for the integration of the Hosted IP Office Infrastructure and/or any of its components in Distributor's and/or Customer's network environment and to any interoperating hardware, software or systems. Distributor is responsible for using commercially reasonable expected measures to deliver the quality of service and security measures reasonably expected by Customers.
- 4.6. Management of Hosted IP Office Infrastructure.** Distributor is responsible for the day-to-day management and configuration of the Hosted IP Office Infrastructure and the activating, deactivating and re-activating of any Software User licenses. To the applicable extent, Distributor shall use the standard VMWare and Avaya IP Office configuration tools.

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- 4.7. Helpdesk Support and Co-delivery Support.** Distributor shall provide co-delivery support, including Helpdesk Support and Tier 1 and Tier 2 support, to Resellers and, if applicable, Customers and nothing in this Addendum obligates Avaya to provide any Support Services or other support to Resellers and/or their Customers. Helpdesk Support requires that Distributor and, where applicable, its Resellers have the ability and competencies to serve as Reseller's and Customer's interface and relationship manager. In addition, Distributor and/or Reseller, as applicable, shall be responsible to respond to a reported issue, open a trouble ticket in a tracking system, evaluate the issue and route the trouble ticket to the appropriate support team. Avaya may require Helpdesk Support personnel to complete a series of training courses relating to any Products included in the Hosted IP Office Infrastructure. Any charges associated with these required courses will be paid for by Distributor. Where any Helpdesk Support, Tier 1 and/or Tier 2 support is provided to Customers by Resellers, Distributor shall cause Resellers to comply at Reseller's cost with the same or substantially similar obligations to those applicable to Distributor in accordance with this Section. Avaya may request Distributor to de-authorize and terminate the Reseller Agreement, or its applicable part pertaining to Subscription Services, with a Reseller who does not comply with any of the these obligations, with immediate effect, and Distributor shall so comply with such request. *****.
- 4.8. Relocation of Hosted IP Office Infrastructure.** Distributor shall notify Avaya of any removal or relocation of the Hosted IP Office Infrastructure or any of its components and provide Avaya with all information it may reasonably require for the timely performance of Avaya's obligations under this Addendum.
- 4.9. Cooperation.** Distributor shall, at its cost, cooperate with Avaya as reasonably necessary for Avaya's delivery of the Software licenses and related Support Services under this Addendum in a timely manner. At no cost to Avaya, Distributor shall: (i) provide Avaya with interface and other information regarding access to Third Party Products in the Hosted IP Office Infrastructure or Distributor's or Customer's network and necessary third party consents and licenses to enable Avaya's performance and fulfillment of its obligations; (ii) ensure that Distributor's networks and systems related to the delivery of Subscription Services are adequately secured against unauthorized intrusion or attack and regularly backing up data and files in accordance with commercially reasonable computing practices; (iii) at all times provide Avaya, its agents and/or subcontractors with unrestricted access to the Hosted IP Office Infrastructure both at the premises and remotely; (iv) unless otherwise required pursuant to an applicable Service Description, designate 2 authorized members of its staff to serve as points of contact with Avaya and to decide any and all issues on behalf of itself with respect to the provision of Subscription Services and notify Avaya in writing of any change; (v) intentionally omitted; (vi) include all required Reseller and Customer information, such as in particular name and address, in its Orders to Avaya; (viii) cooperate in all reasonable ways with personnel of Avaya in relation to Avaya's performance of its obligations under this Addendum, including but not limited to: (a) in the diagnosis, investigation and correction of any reported Incident; (b) providing Avaya any further information that Avaya may reasonably require to fulfill its obligations hereunder; (c) keeping backup or archival copies of its Orders, databases and computer records in accordance with commercially reasonable computing practices; and (d) notifying Avaya in advance of any significant configuration or definition changes in Subscription Services.
- 4.10. Release of Information.** For any Support Services pursuant to which Avaya provides coordination of support or case management services with third party vendors, Distributor authorizes Avaya to release this information to the third party vendor, even if the third party vendor is outside of Distributor's, Reseller's or Customer's country. *****.
- 4.11. Customer Record Keeping.** Distributor shall (i) maintain adequate and complete records of sales to Resellers as well as any other information reasonably needed by Avaya for Avaya's billing purposes under this Addendum, and (ii) cause Resellers to maintain adequate and complete records of Reseller's sales to Customers. *****.
- 4.12. Forecasts.** During the term of this Addendum, Distributor shall submit such forecasts to Avaya as the parties may agree upon.
- 4.13. Reseller and Customer Obligations.** Distributor acknowledges and agrees that certain obligations under this Addendum may also apply to Resellers and their Customers. Certain of these obligations have been specifically identified as such in this Addendum, but shall not be regarded as exhaustive. Consequently, Distributor shall, where applicable, cause its Resellers to comply with such obligations, including (without limitation), by implementing those obligations in the Reseller Agreements and obligating Resellers to include the applicable obligations in the agreements between Resellers and their Customers. Distributor shall enforce the terms of its Reseller Agreements against its Resellers, and shall fully cooperate with Avaya in connection with doing so. Distributor shall also cause Resellers to (i) enforce the terms of their agreements, in connection with the subject matter of this Addendum, with Customers, and (ii) cooperate with Distributor and/or Avaya in connection with doing so. *****. Avaya may request and Distributor agrees to provide Avaya with a copy of the relevant provisions included in the Reseller Agreement.

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4.14. Suspension. In the event of a material breach that remains uncured for a period of thirty (30) days after notice of such breach from Avaya, by Distributor of any of its obligations under the Addendum, Avaya, without prejudice to any other right or remedy available to it, may suspend performance of its obligations until Distributor has performed its obligations. Such suspension will not entitle Distributor to terminate this Addendum and/or the Agreement and will not suspend or alleviate any of Distributor's obligations. The suspension may continue for as long as Distributor's breach remains uncured, past the thirty day cure period, and may be ceased and renewed by Avaya.

4.15. Compliance with Channel Policies. *****

5. COMPLIANCE WITH LAWS

5.1. COMPLIANCE WITH LAWS AND REGULATIONS. DISTRIBUTOR SHALL, AND SHALL CAUSE ITS RESELLERS TO, COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS IN THE TERRITORY, INCLUDING, WITHOUT LIMITATION, COMPLIANCE WITH ANY LAWS, REGULATIONS, TAXES, FEES OR OTHER REQUIREMENTS RELATED TO THE USE, MARKETING AND PROVISION OF SUBSCRIPTION SERVICES AND OTHER REGULATED SERVICES AND THE PROVISIONING, HOSTING, USING, INSTALLING, DE-INSTALLING, ACTIVATING, DEACTIVATING AND DE-COMMISSIONING OF THE HOSTED IP OFFICE INFRASTRUCTURE (OR ANY PORTION THEREOF) AT DISTRIBUTOR'S, RESELLER'S OR CUSTOMERS' PREMISES AND ANY REGULATIONS PROMULGATED BY THE FEDERAL COMMUNICATIONS COMMISSION IN THE U.S., AND ANY STATE PUBLIC UTILITY COMMISSION IN THE INDIVIDUAL U.S. STATES, AS WELL AS SIMILAR, CORRESPONDING GOVERNMENTAL AGENCIES IN OTHER COUNTRIES AND LOCALITIES. WITHOUT LIMITING THE FOREGOING, DISTRIBUTOR SHALL, AND SHALL CAUSE ITS RESELLERS TO (I) COMPLY WITH ALL APPLICABLE DATA PRIVACY AND CALL RECORDING LAWS AND REGULATIONS AND (II) PROVIDE ANY APPLICABLE NOTICES TO AND OBTAINING ANY APPLICABLE CONSENTS FROM RESELLERS AND/OR CUSTOMERS (AS APPLICABLE). *****.

5.2. Homologation. *****. "Homologation" means any necessary approval by the duly authorized governing authorities for sale or use of the Hosted IP Office Infrastructure and/or Subscription Services in the Territory and includes without limitation "permission to connect", "type acceptance", "type approval", "prior connection inspection", "safety test for importation", homologation or any other similar process, which would provide authorization to: (i) connect any components of the Hosted IP Office Infrastructure to the public telecommunications network; (ii) connect the Hosted IP Office Infrastructure to the public electrical/energy grid; (iii) import the Hosted IP Office Infrastructure into the Territory; or (iv) provide or use the Hosted IP Office Infrastructure and Subscription Services in the Territory.

6. SUPPORT SERVICES

6.1. Eligibility. To be eligible to purchase from Avaya the Software licenses under this Addendum and market the Subscription Services in accordance with this Addendum, Distributor agrees to purchase from Avaya as a minimum for each Order the following components of the IP Office Support Services, as described by the Service Description titled "*IP Office Support Services*": *24x7 Remote Technical Support including Software Upgrades – Co-delivery model*. This requirement will automatically extend to the corresponding support components of any replacement support programs to the IP Office Support Services or its individual components so designated by Avaya. Support Services under this Addendum do not include any hardware premise equipment support or any terminal replacement support.

6.2. Subcontracting. Avaya may subcontract any or all of the work to be performed by it under any Order placed pursuant to this Addendum, but will retain the responsibility for the subcontracted work.

6.3. End of Support. Avaya may discontinue or limit the scope of Support Services for the Software that Avaya or a third party manufacturer has declared "end of life," "end of service," "end of support," "manufacture discontinued" or similar designation ("**End of Support**"). Distributor may access Avaya's user support website (<http://support.avaya.com> or a successor site) for End of Support notifications, and to register an e-mail address to receive e-mail notifications of the same, when published by Avaya. Avaya targets posting of End of Support notifications for Avaya-manufactured Software at least 6 months in advance of the End of Support date. End of Support will be effective as of the effective date of the End of Support notice. Avaya also may provide End of Support notices by email to email addresses that Distributor has registered with Avaya. If Support Services are discontinued for any Software, such Software will be removed from the Order and fees will be adjusted accordingly. For certain Software subject to End of Support, Avaya may continue to offer a limited set of Support Services ("**Extended Support**"). Where Avaya has chosen to do this, the description of Extended Support available and related fees will be available at the time of Avaya's notice. These notices will communicate

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information such as Extended Support eligibility, Extended Support alerts related to parts shortages, and end of Services coverage eligibility (including Extended Support).

- 6.4. Support Services Exclusions.** Provision of Support Services under this Addendum is expressly limited to Software made available to Distributor on subscription basis under this Addendum. None of the following are included in Support Services: (i) diagnoses or support of products, software, equipment or Hosted IP Office Infrastructure components other than Software made available to Distributor on subscription basis under this Addendum, including without limitation systems interfacing with that Software; (ii) diagnosis or support of Hardware or other equipment located at either Reseller's or Customer's premises; (iii) diagnosis or support of terminals; (iv) terminal replacement support; (v) correction of problems due to interoperability or non-compatibility of Software with third party products, unless such interoperability is provided for in the Documentation; (vi) support of Software that have been subjected to misuse, neglect, accident, abuse, power failures or power surges, lightning, fire, flood, Act of God or act of war or terror or have been installed, configured, used, repaired or altered contrary to their Documentation or prior Avaya authorization, or that have had their serial numbers altered, defaced or deleted; (vii) data recovery services; (viii) services associated with relocation of IP Office Hosted Infrastructure components; (ix) correction of problems arising from failure to apply or install all applicable updates; (x) support of Software used in breach of applicable Software license restrictions; (xi) supply of upgrades or new optional Software features; (xii) support of user-defined applications; (xiii) making corrections to user-defined reports.

7. FEES, INVOICING AND PAYMENT

- 7.1. Fees.** Fees for Software and Support Services provided on a subscription basis are as set forth in Exhibit A and are quoted on a per User per month basis. Where any fee refers to a group or other combination, the fee and grouping are not divisible. Avaya may change fees, add or delete User types and/or modify Distributor's entitlements under each User type, by providing Distributor a ***** day notice in writing or in electronic form, without a need for a formal amendment of this Addendum. In addition to the monthly fees for Software and Support Services provided on a subscription basis, Avaya will charge Distributor an upfront fee for each Customer for the initiation of Support Services coverage, as described in more detail in Exhibit A. This upfront fee is non-cancellable and non-refundable. Notwithstanding anything to the contrary in this Addendum, Avaya reserves the right to waive, at Avaya's sole discretion, on a case-by-case basis the upfront fee for each Customer for the initiation of Support Services coverage.
- 7.2. Calculation methodology.** Fees for Software and Support Services provided on a subscription basis will be calculated by Avaya on a calendar month basis in accordance with the following provisions of this Section 7.2. In addition, examples of how Avaya will invoice Distributor for Software and Support Services provided on a subscription basis are included, for illustration purposes only, in Exhibit B.
- 7.2.1. Daily User count.** Based on the information included in Avaya's transaction records and any information in Distributor's possession or control that is requested by Avaya (if any), Avaya will determine the daily count of Users of each User type that are available to Distributor on that day and store such daily counts in its transaction records. The daily count is determined irrespective of how many Users are effectively used. Any Software that is available in any way to Distributor under this Addendum will be charged for, even if unused, unless the applicable Users have been deactivated and Distributor has notified Avaya of such deactivation by submitting a Subsequent Order that has been accepted in accordance with the terms of this Addendum and reflected in Avaya's transaction records and Avaya has been provided with a reasonable proof of such deactivation.
- 7.2.2. Monthly User count.** For each calendar month a cumulative sum of all the daily User counts will be calculated for each User type. The total resulting sum in a calendar month for each User type will then be divided by the number of calendar days in that month. If the result is not a whole number, it will be rounded up or down to the next closest whole number.
- 7.2.3. Reconciliation.** Avaya will communicate to Distributor the monthly User count for each User type after the end of each calendar month. Distributor shall inform Avaya in writing within 5 business days from the date of such notification of any disputed portion of the monthly User count or any disputed portion of the fees charged to Distributor. If no written objection has been received by Avaya from Distributor within that time period, Distributor will be deemed to have accepted the monthly User count for each User type and the fees charged to Distributor, as presented by Avaya. If Distributor disputes in good faith the foregoing, Avaya may invoice Distributor for the undisputed portion in accordance with this Addendum and Distributor agrees to pay for such undisputed portion in accordance with the payment term as set out in the Agreement. The parties shall co-operate in good faith to

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resolve any such disputes and agree that the transaction records maintained in accordance with Section 7.2.1 will be the basis for reconciling the counts.

- 7.3. Information and cooperation.** Distributor shall timely provide Avaya with all information, data and Distributor's full cooperation that may be reasonably required by Avaya to calculate the daily and monthly User counts for each User type. Distributor hereby represents and warrants that to the best of its knowledge any such information and data it provides to Avaya is accurate and complete.
- 7.4. Invoicing.** Monthly fees for Software and Support Services provided on a subscription basis, determined in accordance with Section 7.2, will be invoiced monthly in arrears (the timing is at Avaya's sole discretion), unless Avaya has decided at its sole discretion to issue a one-time invoice covering fees owed during the entire term of this Addendum after the expiry or termination of this Addendum. Upfront fees for the initiation of Support Services coverage for each Customer will be invoiced upon acceptance by Avaya of the IPOSS order associated with that Customer and payment will be in accordance with the payment term in the Agreement.

8. SOFTWARE LICENSE

- 8.1. License Grant.** Notwithstanding anything in the EULA to the contrary, Avaya grants to Distributor a personal, nonexclusive, nontransferable, nonsublicensable, limited license to use the Software provided by Avaya to Distributor under this Addendum on a subscription basis during the Order Term solely to provide Distributor's Subscription Services to Resellers within the Territory for Reseller's further resale of those Subscription Services to Customers. Subject to the provisions set forth in this Addendum, Distributor shall comply with the terms of the EULA to the same extent as if Distributor were a "Customer" or "End User". The Software licenses provided under this Addendum may only be used in conjunction with Distributor's provision of Distributor's Subscription Services to Resellers in the Territory.
- 8.2. Software available to Resellers.** In the event that any Software (or portion thereof) is installed or downloaded at a Reseller's site or on any Reseller's devices or otherwise made available or accessible by Resellers, Avaya will extend the EULA to such Reseller, providing that Distributor shall:
- 8.2.1** Subject to Sections 8.9 and 10.9, obtain Reseller's written agreement to the EULA prior to or upon Distributor's acceptance of Reseller's order;
 - 8.2.2** Communicate to Reseller the license types applicable to Software;
 - 8.2.3** Not agree to any contractual limitations on Reseller's liability for violations of Avaya's Intellectual Property Rights, including through breaches of a Software license or reverse engineering;
 - 8.2.4** Maintain a copy of each such Reseller EULA and ensure the Avaya will have the right to obtain a copy of the same upon request;
 - 8.2.5** Promptly notify Avaya if Distributor becomes aware of a breach of the Avaya EULA by a Reseller, and upon Avaya's request, immediately terminate such Reseller's access to the Subscription Services and right to use Software; and
 - 8.2.6** Subject to Section 8.2.5 above, obtain Reseller's written agreement that, at the earlier of (i) the conclusion of the last Subscription Services term for its last Customer, or (ii) upon the termination or expiry of the Reseller Agreement, and in no event may (i) or (ii) exceed the term of this Addendum, and in accordance with Avaya's instructions, Reseller shall return and/or destroy any Software installed or downloaded at the Reseller's site or on any of its devices or otherwise made available or accessible by Reseller, and certify compliance with the foregoing requirements by an authorized representative of Reseller. Upon Avaya's request, Distributor shall promptly provide such certification to Avaya.
- 8.3. Software available to Customers.** In the event that any Software (or portion thereof) is installed or downloaded at a Customer's site or on any Customer's devices, Avaya will extend the EULA to such Customer, providing that Distributor shall:
- 8.3.1** Subject to Sections 8.9 and 10.9, cause its Reseller to obtain Customer's written agreement to the EULA prior to or upon Reseller's acceptance of Customer's order;
 - 8.3.2** Cause its Reseller to communicate to Customer the license types applicable to Software;
 - 8.3.3** Cause Reseller not to agree to any contractual limitations on Customer's liability for violations of Avaya's Intellectual Property Rights, including through breaches of a Software license or reverse engineering;

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- 8.3.4** Request from Reseller and maintain a copy of each such EULA and ensure Avaya will have the right to obtain a copy of the same upon request, or cause Reseller to maintain a copy of each such EULA and ensure Avaya will have the right to obtain a copy of the same from Reseller upon request;
- 8.3.5** Notify or cause Reseller to notify Avaya of any breach of the Avaya EULA by a Customer immediately upon becoming aware of such breach and cause Reseller to immediately terminate such Customer's access to the Subscription Services and right to use Software; and
- 8.3.6** Subject to Section 8.3.5 above, cause Reseller to obtain Customer's written agreement that, at the earlier of (i) the conclusion of Subscription Services Order Term for that Customer, or (ii) upon the termination or expiry of the agreement between Customer and Reseller associated with the subject matter of this Addendum, and in no event may (i) or (ii) exceed the term of this Addendum, and in accordance with Avaya's instructions, Customer shall return and/or destroy any Software installed or downloaded at the Customer's site or on any of its devices or otherwise made available or accessible by Customer, and certify compliance with the foregoing requirements by an authorized representative of Customer. Upon Avaya's request, Distributor shall promptly provide such certification to Avaya.
- 8.4. Software Licenses.** Any Software provided pursuant to this Addendum will be provided to Distributor solely on a non-perpetual, month to month subscription basis, and Distributor's right to use such Software will at all times be subject to Distributor's timely payment of the fees due to Avaya under this Addendum and compliance with the terms and conditions of this Addendum. Upon expiry or termination of any Order or this Addendum for any reason, all applicable Software licenses will be terminated immediately and all related Support Services and any other Avaya obligations will be discontinued.
- 8.5. Third Party Software Licensing Requirement.** Distributor acknowledges and agrees that this Addendum may not cover hosting of certain third party software components which are part of the Hosted IP Office Infrastructure that Distributor may be required to independently license those software components from the third party supplier.
- 8.6. Ownership of Software.** Distributor undertakes that Software, and all copies thereof, including translations, compilations, derivative works and partial copies, are and will at all times remain the property of Avaya or its licensors.
- 8.7. Termination of License.** Avaya may terminate the license granted under this Section 8, any Order, this Addendum and/or the Agreement if, within 10 business days of Distributor's receipt of a reasonably detailed written request to cure, Distributor has not cured all material breaches of license limitations or restrictions.
- 8.8. Non-exclusive, Non-production use Software license.** Avaya and Distributor agree that a defined number of certain Software license types may, at Avaya's discretion, be provided to Distributor for a limited license period defined in writing by Avaya, at no charge and for non-production purposes, solely for internal testing of such Software in a non-production environment, or other non-commercial purposes, on a single computer or as otherwise designated in writing by Avaya ("**Non-production use Software licenses**"). The parties further agree that such Non-production use Software licenses so provided may be internally used solely by Distributor and/or its Reseller, solely for non-production purposes and solely in accordance with the spirit of this Addendum. Non-production use Software licenses will expire automatically at the end of the limited license period as defined in writing by Avaya, or earlier at Avaya's discretion upon notice to Distributor. Subject to the terms in this Section, the scope of Non-production use Software licenses will be as set out in Section 8, except that, unless otherwise expressly agreed to by Avaya in writing, no Software provided under Non-production use Software license may be installed, downloaded or otherwise made available for use by Customers. Distributor is not authorized to charge Resellers for any Non-production use Software licenses made available to them by Distributor, if such Non-production use Software licenses have been provided to Distributor by Avaya at no charge. Distributor shall: (i) cause its Resellers to comply with terms at least as protective as the terms herein and the terms of the EULA (except as expressly altered in this Section); (ii) enforce such terms against Resellers upon request by Avaya; and (iii) cause Resellers to immediately stop using any Software provided under a Non-production use Software license at the end of the limited Non-production use Software license period, as defined in writing by Avaya, or earlier, at Avaya's discretion, upon notice to Distributor.
- 8.9. NO WARRANTY.** NO WARRANTY TERMS INCLUDED IN THE EULA APPLY TO ANY SOFTWARE OR SUPPORT SERVICES PROVIDED BY AVAYA UNDER THIS ADDENDUM. DISTRIBUTOR MUST EXPRESSLY EXCLUDE THOSE PROVISIONS IN THE RESELLER AGREEMENT AND CAUSE ITS RESELLERS TO EXCLUDE THEM IN THE AGREEMENT BETWEEN RESELLERS AND THEIR CUSTOMERS. TO THE EXTENT OF ANY CONFLICT BETWEEN THIS ADDENDUM AND EULA, THIS ADDENDUM CONTROLS AND PREVAILS.

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8.10. *****

9. AUDIT RIGHTS

Avaya, or an independent auditor acting on Avaya's behalf, may audit Distributor and, where applicable, its Resellers and their Customers, in connection with billing under this Addendum and/or in order to determine compliance with this Addendum. Distributor agrees to provide Avaya, or an independent auditor acting on Avaya's behalf, reasonable on-site access during normal business hours and remote access to any information, data as well as the data centers housing the IP Office Hosted Infrastructure and each system configuration containing Software, on-site and/or remotely, for any actions reasonably required by Avaya to conduct such audits. The parties agree to work together in good faith to schedule on-site audits. If Avaya suspects a breach by a Reseller or Customer under Avaya's EULA as it relates to this Addendum, Avaya may request Distributor to audit such Reseller or Customer and Distributor shall so comply and provide the results of its audit to Avaya upon request by Avaya. Distributor shall reasonably cooperate with Avaya in connection with any audits conducted by or on behalf of Avaya under this Addendum.

10. WARRANTIES AND LIMITATIONS

10.1. Warranty. Avaya warrants to Distributor that during the applicable warranty period: (i) Software will conform to and operate in accordance with the applicable Documentation in all material respects; (ii) Support Services will be carried out in a professional and workmanlike manner by qualified personnel.

10.2. Warranty Period. Unless otherwise agreed, the warranty periods are as follows: (i) Software – ***** days from the activation date; (ii) Support Services – ***** days beginning on the date of the performance of the Support Service, providing that in no event will the warranty period for Software be longer than the Order Term under which it was licensed to Distributor.

10.3. Software. If Software is not in conformance with the warranty above and Avaya receives from Distributor during the applicable warranty period a written notice describing in reasonable detail how the Software failed to be in conformance, Avaya at its option shall: (i) repair or replace the Software to achieve conformance; or (ii) Distributor may terminate with prospective effect the Order for the affected Software and Avaya or Distributor, as applicable, will deactivate it. Distributor must provide Avaya with information in sufficient detail to enable Avaya to reproduce and analyze the failure and must provide, as requested by Avaya, remote or on site access to the affected Software. Repaired Software is warranted as above for the remainder of the original applicable Software warranty period.

10.4. Support Services. To the extent that Avaya has not performed Support Services in conformance with the above warranty, and Avaya receives written notice from Distributor within the Warranty Period that identifies the non-conforming Support Services in reasonable detail, Avaya shall re-perform the applicable non-conforming Support Service.

10.5. Warranty Procedures. Distributor shall return or otherwise make available to Avaya Software subject to a warranty claim in accordance with Avaya's then current return procedures as defined by the Channel Policies, or as otherwise advised by Avaya, accompanied by evidence that Software remains entitled to warranty protection.

10.6. Costs. Within the applicable warranty period Avaya will not charge for any repair, replacement, error identification or correction of Software or Support Service subject to a warranty claim. If Avaya determines that Software or support Service is free of defects, Distributor shall pay to Avaya all costs of handling and inspection of the warranty claim at Avaya's then prevailing rates and reimburse Avaya for all costs incurred.

10.7. Warranty to Resellers. Distributor shall grant Resellers a warranty consistent with current and prevailing market conditions and applicable law for similar high-quality communications services. Distributor's grant will be Distributor's own responsibility, and will not be binding upon Avaya. *****.

10.8. Support to Resellers for Warranty and License Issues. Distributor shall provide support to Resellers with regard to any warranty or non-conformance issues or questions concerning the Subscription Services and Hosted IP Office Infrastructure and filing warranty claims, and with regard to any license issue or question. In addition, Distributor shall provide the above support to Customers or shall obligate its Resellers under the Reseller Agreement to provide such support to Customers.

10.9. NO WARRANTY TO RESELLERS AND CUSTOMERS. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE EULA, THIS ADDENDUM, OR THE AGREEMENT, AVAYA AND ITS AFFILIATES GRANT NO WARRANTY WHATSOEVER TO EITHER RESELLERS OR CUSTOMERS UNDER THIS ADDENDUM. ANY

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GRANT OF WARRANTY PROVISIONS BY AVAYA OR ITS AFFILIATES INCLUDED IN THE AGREEMENT OR THE EULA TO RESELLERS OR CUSTOMERS DO NOT APPLY TO THIS ADDENDUM.

10.10. Exclusions and Disclaimers. The warranties provided by Avaya under this Addendum do not extend to any damages, malfunctions, or non-conformities caused by: (i) use of Software in violation of the license granted under this Addendum or in a manner inconsistent with the Documentation or this Addendum; (ii) use of non-Avaya furnished equipment, software, or facilities; (iii) Distributor's failure to follow Avaya's installation, operation or maintenance instructions; (iv) failure to permit Avaya or its subcontractors timely access, remote or otherwise, to the Software; (v) failure to implement all updates to Software; or (vi) Software that have been serviced or modified by a party other than Avaya or a third party specifically authorized by Avaya to provide the service or modification Software. Avaya is not responsible under this Addendum for any software, equipment, hardware or services that Distributor may have separately purchased apart from this Addendum or is re-using. Distributor is responsible to make sure any such software, equipment or hardware is in good working order and is compatible with the Software provided under this Addendum. This Section does not limit any warranty and/or support obligations Avaya may have elsewhere under any agreements between Avaya and Distributor. EXCEPT AS REFERENCED AND LIMITED IN THIS SECTION 10, NEITHER AVAYA NOR ITS LICENSORS OR SUPPLIERS MAKES ANY EXPRESS REPRESENTATIONS OR WARRANTIES WITH REGARD TO ANY SOFTWARE OR SUPPORT SERVICES OR OTHERWISE RELATED TO THIS ADDENDUM. AVAYA MAKES NO WARRANTIES WITH RESPECT TO THE SUBSCRIPTION SERVICES OR THE HOSTED IP OFFICE INFRASTRUCTURE (EXCEPT FOR THE SOFTWARE WARRANTY EXPRESSLY REFERENCED AND LIMITED IN THIS SECTION 10). AVAYA DOES NOT WARRANT UNINTERRUPTED OR ERROR FREE OPERATION OF SOFTWARE OR THAT SOFTWARE OR SUPPORT SERVICES WILL PREVENT TOLL FRAUD. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, AVAYA DISCLAIMS ALL IMPLIED OR STATUTORY WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE. THE WARRANTY REMEDIES EXPRESSLY PROVIDED IN THIS ADDENDUM WILL BE DISTRIBUTOR'S SOLE AND EXCLUSIVE REMEDIES AND WILL BE IN LIEU OF ANY OTHER RIGHTS OR REMEDIES DISTRIBUTOR MAY HAVE AGAINST AVAYA WITH RESPECT TO THE NON-CONFORMANCE OF SOFTWARE AND/OR SUPPORT SERVICES WITH THE WARRANTIES SET FORTH HEREIN.

11. LIMITATION OF LIABILITY

IN NO EVENT WILL EITHER PARTY OR ITS RESPECTIVE LICENSORS OR SUPPLIERS HAVE ANY LIABILITY FOR ANY INCIDENTAL, SPECIAL, STATUTORY, INDIRECT OR CONSEQUENTIAL DAMAGES, LOSS OF PROFITS OR REVENUE, LOSS OR CORRUPTION OF DATA, TOLL FRAUD, COST OF COVER, OR SUBSTITUTE GOODS OR PERFORMANCE. THE TOTAL AGGREGATE LIABILITY OF EITHER PARTY FOR ALL CLAIMS ARISING OUT OF OR IN CONNECTION WITH THIS ADDENDUM WILL NOT EXCEED AN AMOUNT EQUAL TO ***** THE DISCLAIMERS OF LIABILITY AND THE CAP ON AGGREGATE LIABILITY IN THIS SECTION WILL APPLY TO ANY DAMAGES, HOWEVER CAUSED, AND ON ANY THEORY OF LIABILITY, WHETHER FOR BREACH OF CONTRACT, TORT (INCLUDING, BUT NOT LIMITED TO, NEGLIGENCE), OR OTHERWISE, AND REGARDLESS OF WHETHER THE LIMITED REMEDIES AVAILABLE TO THE PARTIES FAIL OF THEIR ESSENTIAL PURPOSE. HOWEVER, THE DISCLAIMERS OF LIABILITY AND THE CAP ON AGGREGATE LIABILITY WILL NOT APPLY IN CASES OF ***** THIS LIMITATION OF LIABILITY SECTION WILL APPLY TO ANY LIABILITY OF DIRECTORS, OFFICERS, EMPLOYEES, AGENTS AND SUPPLIERS.

12. TERM AND TERMINATION

12.1. Term. This Addendum will continue in effect for a period of 8 months from the Addendum Effective Date, unless terminated earlier in accordance with the terms of this Addendum. Unless either party gives written notice to the other party of its intent not to renew this Addendum no later than 5 business days in advance of the end of its term, this Addendum will automatically renew for subsequent 1 month terms.

12.2. Termination. Either party may terminate this Addendum by written notice to the other party: (i) effective immediately upon receipt, if the other party fails to cure any material breach of this Addendum within a 30 day period after having received a written notice from the non-breaching party detailing the breach and requesting the breach be cured; and (ii) at any time for convenience upon 30 days advance written notice with the effective date of termination at the end of the calendar month. Avaya may, at any time, terminate an Order for convenience upon 30 days advance written notice to Distributor with the effective date of termination at the end of the calendar month.

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12.3. Effects of termination. Termination or expiry of this Addendum will be deemed to terminate all Orders, including any orders issued by Distributor to initiate Support Services coverage, and all licenses granted under this Addendum. Termination or expiry of an Order will be deemed to terminate all licenses granted under that Order. Upon termination or expiration of a license for any reason, Distributor will immediately permanently destroy all copies of Software and any related materials in Distributor's possession or control and upon Avaya's request, certify such destruction in writing. Rights of termination under this Addendum will be without prejudice to any accrued rights or liabilities of either party to the other arising out of this Addendum. Upon termination or expiration of this Addendum, and unless otherwise agreed to by Avaya in writing, Distributor shall: (a) discontinue all use of the Licensed Trademarks in connection with the Hosted IP Infrastructure; (b) cease holding itself out in any manner as an authorized hosting provider of Subscription Services based on the Software and notify and arrange for all persons who may identify, list or publish Distributor's name as an Avaya authorized Subscription Services provider to discontinue such designation; and (c) return to Avaya all promotional or other materials supplied by Avaya in connection with the Software and Support Services provided under this Addendum. In addition, upon notice of termination or expiration of the Addendum, Avaya may inform Resellers and Customers that Distributor is no longer authorized to provide Subscription Services based on Avaya IP Office communication solutions and may provide Resellers and Customers with alternative support options to enable Resellers and Customers to transition to a new model. Provisions concerning confidentiality, governing law, dispute resolution, indemnification, limitation of liability, termination, payment (to the extent there are any outstanding payments or fees owed to Avaya) and any other terms which, by their nature, are intended to survive termination or expiration of this Addendum or any Order will survive any termination or expiration of this Addendum and any Order.

12.4. Agreement. The term and termination provisions set out in the Agreement do not apply to this Addendum, except that if the Agreement is terminated for Distributor's material breach, this Addendum and any Orders under it will automatically expire upon such termination of the Agreement.

13. INDEMNIFICATION

In addition to the indemnification obligations throughout this Addendum, in Section 20 (Infringement Defense and Indemnification) of the Agreement, the parties agree to add the following sentence to the end of Section 20.3: *****.

14. OTHER PROVISIONS

14.1. Order of Precedence. In the event of a conflict between the Agreement (including its Attachments and Appendices), this Addendum (including its Exhibits), Service Description and any Order, the order of precedence is as follows: (i) this Addendum; (ii) the Agreement; (iii) Service Description; and (iv) an Order accepted by Avaya.

14.2. Interpretation. In this Addendum, unless the context expressly requires otherwise: (i) a reference to the singular includes the plural and *vice versa*; (ii) the headings are inserted for convenience only and will not affect the interpretation of this Addendum; and (iii) whenever the words "include", "includes", "including" or "in particular" (or similar derivatives) are used, they are deemed to be followed by the words "without limitation". For purposes of this Addendum, unless the context expressly requires otherwise, any references in the Agreement to: (a) "Agreement" will be deemed to refer to this Addendum, (b) "Services" will be deemed to refer to "Support Services" as defined in this Addendum; (c) "End User" will be deemed to refer to "Customer" as defined in this Addendum; (d) "Products" will be deemed to refer to "Software" as defined in this Addendum; (e) "Order" will be deemed to refer to "Order" as defined in this Addendum.

14.3. Electronic signature. This Addendum and any amendments thereto may be executed in multiple counterparts, each of which will constitute an original and all of which shall constitute but one document. Subject to local law requirements, the parties agree that this Addendum and any amendments thereto may be executed by electronic signature, which will be binding between the parties as though handwritten. Subject to local law requirements, electronic signature will include either an electronic symbol adopted by a person with the intent to sign this Addendum and any amendments thereto or a photo static copy of a handwritten signature. Any modifications or amendments to this Addendum must be in writing and physically or electronically signed by both parties. In no event will electronic mail constitute a modification or amendment to this Addendum.

14.4. Amendment of the Agreement. The Agreement (including without limitation all attachments and other documents referenced therein as well as any amendments thereto) is amended by this Addendum. Except as modified by this Addendum, all other terms of the Agreement remain unaffected.

14.5. Entire Agreement. This Addendum constitutes the entire understanding of the parties with respect to the subject matter of this Addendum and will supersede all previous and contemporaneous communications, representations or

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understandings, either oral or written, between the parties relating to that subject matter and will not be contradicted or supplemented by any prior course of dealing between the parties.

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IN WITNESS WHEREOF, the parties have caused this Addendum to be executed by their duly authorized representatives, for good and valuable consideration, the receipt and adequacy of which is hereby acknowledged.

ScanSource, Inc. dba ScanSource Catalyst

Avaya Inc.

By: /s/ Ansley Hoke

By: /s/ Brian Murray

Name: Ansley Hoke

Name: Brian Murray

Title: VP Merchandising, ScanSource Catalyst

Title: Senior Director Americas Distribution

Date: October 20, 2014

Date: October 20, 2014

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EXHIBIT A
DISTRIBUTOR HOSTED IP OFFICE INTERIM OFFER AND PRICING

Material Code	Material Code description	Support Services	Price
307398	IPOCLOUD PLTFM TELEPHNY USR SUBSCRIP Entitles features such as: Make/Receive calls, Park & Page, Basic Call Logs, Call Forwarding, Call Transfer, Calling Line ID Delivery, Do Not Disturb, Intercept User, Last Number Redial, Three-Way Calling, Voicemail, Selective Call Acceptance, Selective Call Rejection, Hot Desking, Mobile Twinning, Conference Bridge, SoftConsole (max 3 for Receptionists)	Included: 24x7 remote technical support including Software upgrades – co-delivery model (<i>see, e.g.</i> , Sections 4.7 and 6 of this Addendum for more details)	***** per Telephony User per month
307399	IPOCLOUD PLTFM UC USR SUBSCRIP Entitles features such as: Advanced Mobile Application, Voicemail to Email Notification, PC and iPad Soft-phone, Video Calling, Instant Messaging and Presence, SFDC Plug-in, Outlook Plug-in, Lync Plug-in	Included: 24x7 remote technical support including Software upgrades – co-delivery model (<i>see, e.g.</i> , Sections 4.7 and 6 of this Addendum for more details)	***** per UC User per month
271,610	IPO C/D RTS 24X7 - 120G7 1 YPP	One-time, upfront, non-refundable, non-cancellable fee per Customer for the initiation of Support Services coverage	***** per Customer

Pricing assumptions and caveats:

- Prices are quoted in the U.S. dollars;
- Prices quoted above are as of the Addendum Effective Date, and subject to change (per Section 7.1 of this Addendum);
- Prices exclude any and all Taxes;
- Prices are subject to Distributor's compliance with the terms of this Addendum; and
- Prices are List Prices.

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EXHIBIT B

SAMPLE MONTHLY FEE CALCULATION

This Exhibit provides for an example calculation of monthly fees for Software and Support Services provided on a subscription basis for a 30-day calendar month (values and prices for demonstration purposes only). This example is provided for illustration purposes only and does not include upfront fees charged by Avaya for the initiation of Support Services coverage in accordance with the terms of this Addendum. These upfront fees will be paid by Distributor additionally in accordance with the terms of this Addendum.

*****	*****
*****	*****
*****	*****
*****	*****

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Avaya Distributor Payment Terms Offer

16 March 2015 (Revised 17 March 2015)

Objective

*****, Avaya is offering to change the payment terms for eligible distribution partners (“Distributors”) to ***** calendar days from the date of the invoice for orders placed for Products or Services beginning March 16, 2015. The payment terms may be subject to change upon no less than ***** days’ notice from Avaya effective on the date indicated on Avaya’s notice and without a need for any formal amendment to the Agreement.

Eligible Distributors

This change is extended to all US Distributors that meet the eligibility criteria.

Distributor Eligibility

The payment term change will apply to those Distributors ***** annually from Avaya Globally or if Theater only Distributor, ***** within theater and will apply to all products and services.

Distributor must be in good standing in regards to Accounts Receivable.

Timeframe

This new payment term is applicable to orders placed by Distributors beginning **16 March 2015**, and will continue until otherwise notified by Avaya upon no less than ***** notice.

Operational Process:

Normal processes should be used and the new payment term will be automatically applied.

Terms and Conditions

1. The Avaya account representatives have no authority to interpret or vary the terms of this notice.
2. Avaya reserves the sole right to interpret and establish the terms and conditions of this notice.
3. All other terms and conditions of the Distributor agreement remain unchanged.
4. This is a discretionary offer from Avaya which does not give Distributors a contractual right to payment terms ***** calendar days.
5. Information contained herein is confidential and proprietary information of Avaya and is provided for the internal use of Avaya and its authorized Distributors. In no event shall Avaya be liable for any errors or omissions resulting from the information contained herein.

Certification Pursuant to Rule 13a-14(a) or 15d-14(a)
of the Exchange Act, as adopted Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, Michael L. Baur, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ScanSource, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Michael L. Baur

Michael L. Baur, Chief Executive Officer (Principal Executive Officer)

Date: May 5, 2015

Certification Pursuant to Rule 13a-14(a) or 15d-14(a)
of the Exchange Act, as adopted Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, Charles A. Mathis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ScanSource, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Charles A. Mathis

Charles A. Mathis, Executive Vice President and Chief
Financial Officer (Principal Financial Officer)

Date: May 5, 2015

Certification of the Chief Executive Officer of ScanSource, Inc.
Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to § 906
of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of ScanSource, Inc. (the “Company”) on Form 10-Q for the quarter and nine months ended March 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned officer of the Company certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of §13(a) or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”); and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 5, 2015

/s/ Michael L. Baur

Michael L. Baur,

Chief Executive Officer

(Principal Executive Officer)

This certification is being furnished solely to comply with the provisions of § 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the accompanying Report, including for purposes of Section 18 of the Exchange Act, or as a separate disclosure document. A signed original of this written certification required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written certification required by Section 906, has been provided to the Company and will be rendered by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Certification of the Chief Financial Officer of ScanSource, Inc.
Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to § 906
of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of ScanSource, Inc. (the "Company") on Form 10-Q for the quarter and nine months ended March 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned officer of the Company certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of §13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 5, 2015

/s/ Charles A. Mathis

Charles A. Mathis

Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

This certification is being furnished solely to comply with the provisions of § 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the accompanying Report, including for purposes of Section 18 of the Exchange Act, or as a separate disclosure document. A signed original of this written certification required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written certification required by Section 906, has been provided to the Company and will be rendered by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

