

SCANSOURCE INC
Form 10-Q
June 18, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
for the Quarterly Period Ended March 31, 2007**

or

**Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
for the transition period from _____ to _____**

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
(Address of principal executive offices)

(864) 288-2432

29615
(Zip Code)

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(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer Accelerated filer Non-Accelerated filer

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 May 28, 2007
Common Stock, no par value per share	25,841,721 shares

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Cautionary Statements

Certain of the statements contained in this Form 10-Q, as well as in the Company's other filings with the Securities and Exchange Commission (SEC), that are not historical facts are forward-looking statements subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. The Company cautions readers of this report that a number of important factors could cause the Company's activities and/or actual results in fiscal 2007 and beyond to differ materially from those expressed in any such forward-looking statements. These factors include, without limitation: the Company's dependence on vendors, product supply and availability, senior management, centralized functions and third-party shippers; the Company's ability to compete successfully in a highly competitive market and to manage significant additions in personnel and increases in working capital; the Company's ability to collect outstanding accounts receivable; the Company's entry into new product markets in which it has no prior experience; the Company's susceptibility to quarterly fluctuations in net sales and results of operations; the Company's ability to manage successfully pricing or stock rotation opportunities associated with inventory value decreases; narrow profit margins; inventory risks due to shifts in market demand; dependence on information systems; credit exposure due to the deterioration in the financial condition of our customers; a downturn in the general economy; the inability to obtain required capital; potential adverse effects of acquisitions; fluctuations in interest rates, foreign currency exchange rates and exposure to foreign markets; the imposition of governmental controls, currency devaluations, export license requirements and restrictions on the export of certain technology; dependence on third party freight forwarders and the third party warehouse in Europe; political instability, trade restrictions and tariff changes; difficulties in staffing and managing international operations; changes in the interpretation and enforcement of laws (in particular related to items such as duty and taxation); difficulties in collecting accounts receivable, longer collection periods and the impact of local economic conditions and practices; the impact of changes in income tax legislation; acts of war or terrorism; exposure to natural disasters; potential impact of labor strikes; volatility of the stock market; and the accuracy of forecast data; changes in accounting standards and other factors described herein and in other reports and documents filed by the Company with the SEC, including Item 1A of the Company's amended Annual Report on Form 10-K/A for the fiscal year ended June 30, 2006.

Additional discussion of these and other factors affecting our business and prospects is contained in our periodic filings with the SEC, copies of which can be obtained at the Investor Relations section of our website at www.scansource.com. We provide our annual and quarterly reports free of charge on www.scansource.com, as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC. We provide a link to all SEC filings where our periodic reports and current reports on Form 8-K and any amendments to previously filed reports may be accessed, free of charge.

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Explanatory Note

Concurrently with the filing of this Form 10-Q, the Company is filing Amendment No.1 on Form 10-K/A to its Annual Report on Form 10-K for the fiscal year ended June 30, 2006. In this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2007, the Company is restating its condensed consolidated financial statements and related disclosures as of March 31, 2006 and for the three months ended March 31, 2006. The restatement includes adjustments arising from a review of the Company's historical stock option grant practices, including adjustments to stock based compensation expense as a result of an analysis of the Company's historical stock option measurement dates. In October, 2006, the Company's Board of Directors appointed a Special Committee, which was assisted by independent legal counsel and accounting experts, to conduct a review of the Company's historical stock option granting practices. The Special Committee reported its results in January, 2007 and the Company completed its accounting analysis in April, 2007, concluding that a restatement was necessary. See Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Restatement related to stock options, and Note 1A to the Notes to Consolidated Financial Statements included in Part II, Item 8 of such amended Annual Report on Form 10-K/A for more information.

In the Company's amended Annual Report on Form 10-K/A for the fiscal year ended June 30, 2006, the Company restated its consolidated balance sheets of June 30, 2006 and June 30, 2005; the consolidated statements of operations, stockholders' equity and cash flows for the years ended June 30, 2006, June 30, 2005 and June 30, 2004; and related disclosures. The restatement included adjustments arising from the review of the Company's stock option grant practices and related accounting issues for the fiscal periods from 1994 to 2006. The Company also recorded adjustments affecting previously-reported financial statements for fiscal years prior to fiscal 2004, the impact of which has been reflected as an adjustment to retained earnings as of June 30, 2003. The Form 10-K/A also includes the restatement of selected consolidated financial data as of and for the years ended June 30, 2006, 2005, 2004, 2003 and 2002, which is included in Item 6, Selected Financial Data, of the Form 10-K/A, and the unaudited quarterly financial data for each of the quarters in the years ended June 30, 2006 and 2005, which is included in Item 8, Financial Statements and Supplementary Data, of the Form 10-K/A.

Except as set forth in the previous paragraph, we do not intend to amend any of our other previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatement or adjustments but have amended and restated (i) information as of September 30, 2005 and for the three month period then ended included in the Quarterly Report on Form 10-Q for the period ended September 30, 2006, (ii) information as of December 31, 2005 and for the three and six-month periods then ended included in the Quarterly Report on Form 10-Q for the period ended December 31, 2006, and (iii) information as of March 31, 2006 and for three and nine-month periods then ended which is included in this Quarterly Report on Form 10-Q. Except as otherwise specifically noted in this Quarterly Report in Form 10-Q and except for the sections of this Form 10-Q entitled "Special Committee Review of Past Stock Option Granting Practices" in Item 1, Note 1A to the Notes to Condensed Consolidated Financial Statements, and Item 4 Controls and Procedures, all of the information in this Quarterly Report on Form 10-Q is as of March 31, 2007 and does not reflect events occurring after March 31, 2007. Accordingly, this Quarterly Report on Form 10-Q should be read in conjunction with the Company's amended Annual Report on Form 10-K/A for the fiscal year ended June 30, 2006, its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, and its Quarterly Report on Form 10-Q for the quarter ended December 31, 2006, as well as any Current Reports filed on Form 8-K.

On October 26, 2006, the Company announced unaudited results for the first quarter of fiscal year 2007 that ended on September 30, 2006. The announced results were impacted by the restatement. The Company's earnings announcements on April 26, 2007 and January 25, 2007 for the third and second quarters of fiscal year 2007, respectively, were limited to sales and gross margin, which were not impacted by the restatement.

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****SCANSOURCE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)****(In thousands)**

Assets	March 31, 2007	June 30, 2006 (restated) ⁽¹⁾
Current assets:		
Cash and cash equivalents	\$ 3,036	\$ 3,831
Trade and notes receivable:		
Trade, less allowance of \$14,442 at March 31, 2007 and \$11,508 at June 30, 2006	333,823	300,240
Other	8,020	4,558
Inventories	291,332	244,005
Prepaid expenses and other assets	3,012	2,293
Deferred income taxes	16,604	15,709
Total current assets	655,827	570,636
Property and equipment, net	25,767	27,098
Goodwill	37,865	14,404
Other assets, including identifiable intangible assets	17,724	5,359
Total assets	\$ 737,183	\$ 617,497

⁽¹⁾ See Note 1A, Notes to Condensed Consolidated Financial Statements
See Notes to Condensed Consolidated Financial Statements

Table of Contents**SCANSOURCE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)****(In thousands, except for share information)****(Continued)**

Liabilities and Shareholders Equity	March 31, 2007	June 30, 2006 (restated) ⁽¹⁾
Current liabilities:		
Current portion of long-term debt	\$ 230	\$ 229
Short-term borrowings	3,019	
Trade accounts payable	250,054	271,519
Accrued expenses and other liabilities	33,197	30,359
Income taxes payable	3,986	6,358
Total current liabilities	290,486	308,465
Long-term debt	17,239	4,398
Borrowings under revolving credit facility	112,403	27,558
Other long-term liabilities	4,427	2,757
Total liabilities	424,555	343,178
Minority interest	512	910
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, 25,837,348 and 25,725,214 shares issued and outstanding at March 31, 2007 and June 30, 2006, respectively	82,794	76,915
Retained earnings	223,200	191,876
Accumulated other comprehensive income	6,122	4,618
Total shareholders equity	312,116	273,409
Total liabilities and shareholders equity	\$ 737,183	\$ 617,497

⁽¹⁾ See Note 1A, Notes to Condensed Consolidated Financial Statements
See Notes to Condensed Consolidated Financial Statements

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

	Quarter ended		Nine months ended	
	March 31, 2007	March 31, 2006 (restated) ⁽¹⁾	March 31, 2007	March 31, 2006 (restated) ⁽¹⁾
Net sales	\$ 492,678	\$ 405,592	\$ 1,462,642	\$ 1,204,456
Cost of goods sold	441,641	364,332	1,306,990	1,081,033
Gross profit	51,037	41,260	155,652	123,423
Operating expenses:				
Selling, general and administrative expenses	33,795	26,820	101,014	79,051
Operating income	17,242	14,440	54,638	44,372
Other expense (income):				
Interest expense	1,939	633	5,464	1,598
Interest income	(246)	(243)	(529)	(547)
Other, net	141	(121)	(420)	(160)
Total other expense (income)	1,834	269	4,515	891
Income before income taxes and minority interest	15,408	14,171	50,123	43,481
Provision for income taxes	5,326	5,150	18,743	16,395
Income before minority interest	10,082	9,021	31,380	27,086
Minority interest in income of consolidated subsidiaries, net of income tax expense of \$20 and \$37, respectively, and \$36 and \$72, respectively	11	15	57	126
Net income	\$ 10,071	\$ 9,006	\$ 31,323	\$ 26,960
Net income per common share, basic	\$ 0.39	\$ 0.35	\$ 1.22	\$ 1.06
Weighted-average shares outstanding, basic	25,770	25,555	25,749	25,429
Net income per common share, assuming dilution	\$ 0.38	\$ 0.35	\$ 1.19	\$ 1.04
Weighted-average shares outstanding, assuming dilution	26,194	26,101	26,213	25,996

⁽¹⁾ See Note 1A, Notes to Condensed Consolidated Financial Statements
See Notes to Condensed Consolidated Financial Statements

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

	Nine Months Ended March 31,	
	2007	2006 (restated) ⁽¹⁾
Cash flows from operating activities:		
Net income	\$ 31,323	\$ 26,960
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,808	4,154
Amortization of intangible assets	1,345	150
Allowance for accounts and notes receivable	7,017	2,451
Share-based compensation and restricted stock	2,884	3,237
Impairment of capitalized software	148	
Deferred income tax (benefit) expense	(1,346)	(2,091)
Excess tax benefits from share-based payment arrangements	(2,105)	(1,427)
Minority interest in income of subsidiaries	57	126
Changes in operating assets and liabilities, net of acquisitions:		
Trade and notes receivable	(27,853)	(44,950)
Other receivables	(2,795)	(489)
Inventories	(40,835)	(40,916)
Prepaid expenses and other assets	(699)	558
Other noncurrent assets	(1,092)	4,738
Trade accounts payable	(22,611)	66,343
Accrued expenses and other liabilities	3,950	5,304
Income taxes payable	(411)	(1,154)
Net cash (used in) provided by operating activities	(49,215)	22,994
Cash flows used in investing activities:		
Capital expenditures	(2,501)	(4,029)
Cash paid for business acquisitions, net of cash acquired	(50,585)	(1,348)
Net cash used in investing activities	(53,086)	(5,377)
Cash flows from financing activities:		
Increases (decreases) in short-term borrowings, net	2,877	(4,478)
Advances (payments) on revolving credit, net	82,616	(6,414)
Exercise of stock options	970	2,303
Excess tax benefits from share-based payment arrangements	2,105	1,427
Advances (repayments) of long-term debt borrowings	12,841	(1,926)
Net cash provided by (used in) financing activities	101,409	(9,088)
Effect of exchange rate changes on cash and cash equivalents		