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PRESENTATION

Operator

Welcome to the ScanSource quarterly earnings conference call. All lines have been placed in a listen-only mode until the question-and-answer session. Today's call is being recorded. If anyone has any objections, you may disconnect at this time.

I would now like to turn the call over to Mr. Rich Cleys, CFO. Sir, you may begin.

Rich Cleys - *ScanSource, Inc. - CFO*

Thank you, Jared. And thank you for joining us for the ScanSource conference call to discuss financial results for the quarter ended March 31, 2010. My name is Rich Cleys, and with me are Scott Benbenek, President of Worldwide Operations, and Mike Baur, CEO of ScanSource. We will review with you the quarter's operating results and then take your questions.

This conference call contains certain comments which are forward-looking statements that involve risks and uncertainties. These statements are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995.

The statements made in this call are made as of the date hereof, even if subsequently made available on ScanSource's website or otherwise. ScanSource does not assume any obligation to update the forward looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made. Any number of important factors could cause actual results to differ materially from anticipated results. For more information concerning the factors that could cause such a difference, see the Company's annual report on Form 10-K for the year ended June 30, 2009, filed with the Securities and Exchange Commission.

This afternoon, the Company released results for our third-quarter and year-to-date period ended March 31, 2010. I will start our discussion by providing overall sales and operating results for the quarter. Later in the call, Mike will comment specifically on quarterly results and the outlook for each of our business units.

For the quarter ended March 31, 2010, the Company generated worldwide net sales of $496 million, which represents a 27% increase in sales over the comparative prior-year quarter and a 9.5% decrease from the quarter ended December 31, 2009. Our net sales for the quarter were below our expectations and we attribute these results largely to product shortages in our ADC/POS business units and less demand than the December quarter in our communications business units.

The quarter sales results also include an entire quarter of revenues due to the acquisition of the assets of Algol Europe on November 30, 2009. This acquisition is a key step in our strategy to expand our communications business in Europe.

On a geographic basis, sales originating from our North American distribution segment increased 21% in comparison to the prior-year quarter. Our international segment grew 55% and, when measured in local currency, grew 48%. Our international business is 24% of total revenues.

Within our product lines, we experienced a 26% increase in worldwide sales of our POS barcoding and security product categories over the prior-year quarter. These product categories represented 62% of the total sales for the current quarter, with the remaining 38% of our total sales originating from communications products. Our communications businesses experienced an increase of 30% in comparison to the prior-year quarter.

The Company's consolidated gross margin percentage was 11% for the quarter ended March 31, 2010, which was lower than the prior-year quarter gross margin of 12.2%. The prior-year quarter benefited from the sale of lower-cost inventory in Europe. Excluding this unusual event in Europe, gross margins were largely consistent between the two periods. Sequentially from December 2009, gross margin increased 70 basis points, primarily due to vendor program benefits and favorable customer mix due to fewer large deals.

Operating expenses in the current quarter increased to $35.4 million, compared to $32.4 million in the comparative prior-year period. The majority of this increase relates to the addition of operations of the former Algol Europe business that did not exist in the prior year's quarter. Operating expenses as a percent of net sales decreased to 7.1% compared to 8.3% for the prior-year period.

Operating income for the March 2010 quarter increased to $19 million, a 25.5% increase from operating income of the comparative prior year of $15.1 million. Expressed as a percentage of sales, operating income was 3.8% in the current quarter, compared to 3.9% for the prior-year period. Interest expense was $377,000 for the quarter. The effective tax rate for the March 2010 quarter decreased to 36.5% compared with the prior-year quarter of 37.6%. Our return on invested capital was 16.5% for the quarter, which compares to 13.8% for the prior year.

In summary, the March 2010 quarter had reported EPS of $0.45 versus a reported EPS of $0.35 for the March 2009 quarter. This increase was primarily due to higher sales and related gross profit dollars than the prior -- the previous year's quarter.

Turning to the balance sheet, inventory turned 5.7 times during the quarter, which was lower than the 6.8 turns generated in the December 2009 quarter, [plus] the same in the comparative quarter last year. As inventory balances continued to increase during the current quarter, paid-for inventory days were a positive 17.7 days compared to a positive 6 days for the December 2009 quarter and a positive 5.4 days for the comparative prior-year quarter.

The Company has maintained increased inventory levels in anticipation of sales volume improvement and to mitigate potential product shortages. In spite of our efforts, we did experience product shortages in certain high-moving products during the quarter. Accordingly, inventory on hand as of March 31, 2010 was $312.5 million versus $309 million at December 31, 2009 and $216.8 million as of June 30, 2009. As much of this inventory was purchased early in the quarter, a greater portion had been paid for by the end of the quarter than usual. So in summary, we had higher levels of inventory in anticipation of improved sales and we paid for that product before the quarter's end.

There are $62.1 million in checks written but not cleared in the March accounts payable balance. At June 2009 this balance -- or this amount -- was $45.6 million and at December 2009 this amount was $65.4 million. The number of days in receivables, DSO, was 59 days at March 31, 2010, the same as in the sequential quarter, and the 58 days outstanding for the comparative quarter. As discussed during previous calls, we continue to be cautious about the economic environment and believe that our underwriting policy is appropriate under current conditions.

During the quarter the Company had capital expenditures of $3.2 million, which is higher than our norm. This reflects expenditures incurred under the Company's plan to implement new software systems over the next two years. The Company's cash and cash equivalents decreased to $29.7 million on hand at March 31, compared to $38 million at December 31, 2009 and $127.7 million on hand at June 30, 2009. These decreases are largely attributed to the significant growth in our inventory and receivable balances over the last several quarters.

Total interest-bearing debt remained unchanged at $30.4 million at March 31, 2010 and June 30, 2009. In addition, at March 31, 2010 we continued to have $250 million of available funds for borrowing under our revolving credit facility.

Mike will now give you an update on our business.

Mike Baur - *ScanSource, Inc. - CEO*

Thanks, Rich.

The March quarter turned out to be more difficult to forecast than in prior quarters. Historically, the March-quarter revenues decline from December, but this year we expected a different result. As a reminder, ScanSource operates without a backlog except in cases of product shortages. Our sales orders are fulfilled the same day from each of our distribution centers. As a result, our ability to forecast is always inherently difficult, as other factors beyond our control can affect our revenues and profits.

The two primary issues that affected our revenues were product shortages, primarily in our ADC/POS business units, and lower demand in our communications business units as compared to December. We began experiencing product shortages and longer lead times in 2009, and have added more inventory and placed more orders to our vendors as lead times lengthened. However, as revenue growth has returned over the last few quarters, the supply chain of product is just not keeping up with demand. Our vendors have told us to expect shortages throughout -- through the June quarter.

As we noted on the last conference call in January, we saw a spike upward in large deals in December. And we believed this was a result of an end-user budget flush at year end. As we developed our March forecast, we received input from our business units, vendors, and resellers that suggested a continuing sequential improvement in end user demand across all of our technologies. As it turned out, demand was good in our ADC/POS and security businesses, but product shortages hurt our results. We believe we will retain most of this demand in the June quarter. But, our communications business units did not have the demand that we expected and that resulted in lower revenues than forecasted.

Now I will comment on each of our reporting segments. North American distribution includes sales into the United States and Canada and posted sales of $377.6 million, an increase of 21% year over year and a decrease of 11.8% from the December quarter.

The North American discussion will start with Catalyst Telecom. The Catalyst sales unit had a disappointing quarter compared to our expectations, as sales decreased from December. However, sales did grow as compared to last year, when Catalyst experienced the worst of the recession. Almost all Catalyst vendors showed sales growth compared to last year, but most of them also declined compared to the December quarter. We believe there was some pull-in business in the December quarter and demand weakened in March, as we said earlier. We believe that we continued to maintain market share for the quarter.

During the quarter Avaya resellers and Catalyst invested time and resources preparing for the addition of Nortel products. Avaya announced changes to the distribution strategy by authorizing Catalyst to carry Nortel's voice and data products in the US. Catalyst has hosted a series of seven road shows across the US and Canada to educate and meet approximately 250 Nortel and Avaya resellers. The annual Catalyst partner conference will be a great opportunity for Catalyst executives and our vendor executives to network and discuss the key issues for 2010 with our top customers and prospects. This is the largest event of the year for Catalyst and it's planned for May 11th through the 13th and will include hundreds of Catalyst resellers.

Next up is ScanSource Communications. ScanSource Communications had another strong sales quarter, with record sales from Polycom and Plantronics. ScanSource took market share from former Tech Data customers. As a reminder, Tech Data's no longer a distributor for Polycom. And we saw better sales growth from our focus on service providers and AV, or audio visual, integrators in addition to our traditional VAR channel. At the Polycom partner conference in February, the new executive management team from Polycom announced joint marketing alliances with two of our other key vendors, Avaya and Juniper. These alliances, plus the additional 100-plus Polycom sales people recently hired, should help drive end user demand for the channel.

Next I will discuss the North American POS & Barcode business unit. This sales unit had a disappointing quarter due to significant product shortages. Yet, they still grew sales year over year. Most of our vendors had supply chain problems that caused orders to be lost or delayed. Although we saw supply chain issues in earlier quarters, only in the March quarter did it result in a material reduction of revenues. This unit also saw a significant decline in large deals from the December quarter. However, this unit saw good demand from a large number of customers across all markets and vendors.

And now for an update on our third technology area, ScanSource Security. The Security team had strong year-over-year growth, but was down a small percentage sequentially. Several key vendors had strong growth, including Panasonic, Axis, Zebra Card and Motorola. However, our large deals were down for the quarter. This unit's focus on IP security products continues to drive growth by increasing share in the fastest-growing segment of the security market.

Our second reporting segment is international distribution. Our international business, which includes Europe, Latin America and Mexico, posted sales of $118.5 million, an increase of 55% from last year and, when measured on a local currency basis, grew 48% year over year and was flat sequentially from December.

In Europe the ADC/POS team had an excellent quarter, while gaining market share with our key vendors. ScanSource Europe had a better inventory mix than our competitors and that allowed them to win new customers and achieve record sales results with several key vendors. In the quarter, this team hosted a partner tour event in The Netherlands and attracted 160-plus resellers. The Netherlands also was a top growth country for the quarter, in addition to the UK, Spain, Italy and the Nordics.

Our gross margins in Europe are being pressured by new distributors and by new channel programs from certain vendors. And, like last quarter, we did benefit from the transition of certain customers to distribution by a few vendors. ScanSource Europe grew the total number of customers in the quarter through a large number of aggressive marketing programs and by the addition of more headcount.

In our Europe communications business, the March quarter was the first full quarter with Algol revenues. We are now marketing our business as ScanSource Communications Europe, with offices in the UK and Germany. This business unit had strong growth year over year and sequentially. Key vendors include Avaya, 3Com, Extreme, ShoreTel, Juniper, Plantronics and Lifesize.

As in our North America business, we will be adding Nortel voice and data products to our European communications business. During the quarter, the sales and marketing teams were focused on the new release of IP Office from Avaya, which should lead to growth opportunities in June.

Turning to Latin America, this unit achieved strong sales growth year over year, but slightly lower than expected, due to product shortages. Certain countries did very well, led by Columbia, Peru and Mexico. This team is challenged by margin pressure, due to more competition and some vendor program changes in our ADC/POS business. As a result, we have been adding additional product lines in the security and communication areas. ScanSource Mexico has recently launched Extreme, Dialogic, Axis and DigiOp.

Now, we'll conclude this part of our call with closing comments. We believe that total revenues for the June 2010 quarter could range from $530 million to $550 million, and our earnings per share could range from $0.42 to $0.46 per diluted share.

At this time we'll be glad to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator instructions.) One moment, please. Brian Drab; William Blair.

Brian Drab - *William Blair & Company - Analyst*

First question, just to get some more detail on the product shortages, could -- I guess first, could you talk a little bit about what percentage of those orders that you didn't ship due to the shortages are, in your mind, lost at this point? And what percentage would be delayed?

Mike Baur - *ScanSource, Inc. - CEO*

Brian, this is Mike. I think it's difficult to give you an accurate answer since we haven't had this problem at this scale before. I mean, we always have orders that -- in every quarter that come in and we'll be -- either we won't have the inventory right at the time and they might find it at another distributor. And so, you tend to always have that dynamic going on. So I would say this, is that we feel like that we will maintain the business, that we haven't lost it to another distributor. So unless our customer loses it because the end user is tired of waiting, I think that's our biggest risk.

So we believe as inventory is replenished we will continue to get our dominant share of that inventory, since we're the dominant player in these markets, and hopefully maintain most of that business. That's at least our assumption at this point.

Brian Drab - *William Blair & Company - Analyst*

Okay. And, Mike, you made the comment that you don't usually carry a backlog except for in times of product shortages. Does that suggest that maybe you have a substantial backlog at this point?

Mike Baur - *ScanSource, Inc. - CEO*

Well, what was I was trying to be clear on was this, is that our inventory level still looks pretty high. And part of that is because we've got a fair amount of orders that are normally -- well, we would ship complete. And that means that we have to wait on the total product configuration to come in. In some cases we're waiting on literally cables or cradles or batteries or maybe just scanners and we've got the mobility product. So historically we don't even look at that number. But now we are. And we've got a sense for how much of those products, once we get in the remaining parts, can ship, assuming the customer still wants them.

So, yes, so that's what I was trying to indicate is that a fair amount of the inventory that we have on hand today is already committed to order. It's just waiting on the pieces that are missing.

Brian Drab - *William Blair & Company - Analyst*

Okay. And are you guys willing to tell us roughly what the contribution from Algol was in the quarter? Or you're not reporting that level of detail?

Rich Cleys - *ScanSource, Inc. - CFO*

Well, Algol as an individual unit we're not reporting the detail, but the -- when we acquired them that was about a $60 million a year business.

Brian Drab - *William Blair & Company - Analyst*

Right. Okay, great. And then, if I could ask one more. Could you just provide some detail regarding the software implementation and how -- is that across the Company overall, and what the details are there?

Mike Baur - *ScanSource, Inc. - CEO*

I think, Brian, right now we're not going to talk about the details of it, but it's --

Brian Drab - *William Blair & Company - Analyst*

Okay.

Mike Baur - *ScanSource, Inc. - CEO*

-- clearly more money than we have been spending on software. And so we wanted to make sure that we flagged it for you guys when you saw it in our reporting, that it is something that we are planning to do over the next two years. And we've started that process.

Brian Drab - *William Blair & Company - Analyst*

Okay. But you're not going to talk about whether it's a new ERP system or just in general what you're doing at this point?

Mike Baur - *ScanSource, Inc. - CEO*

No, I don't think so. I don't think we're ready to yet.

Brian Drab - *William Blair & Company - Analyst*

Okay.

Mike Baur - *ScanSource, Inc. - CEO*

Thank you.

Brian Drab - *William Blair & Company - Analyst*

Okay. Thanks.

Operator

Ajit Pai; Thomas Weisel Partners.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Couple of quick questions. I think the first is, you talked about Europe and talked about increased competition there. But in terms of business conditions in Europe right now, could you give us some color as to whether you see them improving? You see them still very sluggish? Or do you see them actually getting worse right now?

Mike Baur - *ScanSource, Inc. - CEO*

Well, Ajit, I think what we saw was, number one, that we believed we gained market share. Right? And so, market share doesn't give us a bet- -- a view like you're looking for of the end user dynamics. But we did see, again, fewer big deals. And so what it's suggesting to us, and this is Europe and the US, is that our run rate business that really is catering more to the small to medium enterprises was pretty strong. And so we felt good about that in all of our regions. But we did miss the normal big deals that we would have thought we would have had in this quarter. They didn't materialize.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Okay. Then the second question is just looking at your overall telecom business, especially looking at Avaya, of course Nortel, especially with all the activity undertaken over the past few months, why is your guidance -- you said it was a weak quarter for telecom overall -- why is your guidance still so conservative even though we've got so much more product to sell? And of the overall sort of new Avaya Nortel combined, what percentage over time do you thank that the prior Nortel products would be of the -- overall to the Avaya business?

Mike Baur - *ScanSource, Inc. - CEO*

Well, I -- so a couple comments there. Specifically to the Nortel contribution, it's not clear to us yet, for a couple reasons. One is Avaya has announced the product roadmap, as you know, back at the end of December, early January. But it really isn't in place yet. So the customers that are Nortel customers are still buying Nortel products and they're still buying them from their Nortel resellers from their current Nortel distributors. So right now we don't have a significant Nortel contribution in our guidance. Okay? So the existing distribution and reseller landscape won't start to change materially until we get over the next couple of quarters, for sure not until the beginning of the September quarter.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Got it. And then the last question would be, just looking at the security business, now it's been with you for several years. You had some sort of [teething] changes, et cetera, but after that you've had some fairly decent momentum for a fairly long period of time. Could you give us some color as to when do you expect that business to actually become a double-digit percentage of your overall sales?

And also, you talked about taking the initiative into markets that I haven't heard you mention before, into Mexico, et cetera. Could you give us some color as to whether security risks and the markets are looking more attractive in areas that are different from what you are thinking about three to five years ago?

Mike Baur - *ScanSource, Inc. - CEO*

Yes, I'll try. I mean, I think in general we've avoided the discussion of the revenues for primarily confidentiality issues with our competitors. As you've noticed, as we tend to do things, people follow us. Not too long ago one of the broad-line distributors announced a security initiative and another one's announced a telecom initiative. So we're trying to be a little more close to the vest.

But I can tell you that the strategy of working with the dominant IP vendors is really working for us. And, frankly, the old analog camera vendors didn't want us. And that's kind of okay now, because the market is moving pretty swiftly from analog to IP or digital. And we believe we're going to really catch that wave. And we believe we're frankly in front of most of the traditional security distributors now in that space. So I believe our strategy of focusing primarily as IP is the key and we still continue to see our -- which was a great surprise to me -- a strong card printer business this quarter. And actually, it was strong in December and in the March quarter.

And then finally to your international question, yes, we have gotten -- because we've done well with the vendors that we have in security, they have been very receptive to us in Latin America. And so we decided to go ahead and implement a strategy. And we started it with a few vendors to see can our team down there add this to their portfolio without me having to create a totally separate security business. And that seems to be working. We've carved out some dedicated people. We've hired some folks that have some security knowledge. And the vendors are very receptive and so far the customers are. So we'll be talking more about that initiative over the next few quarters.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Got it. I'll get back in queue.

Operator

Tony Kure; KeyBanc.

Tony Kure - *KeyBanc Capital Markets - Analyst*

Hey, couple questions. Just looking at the guidance implied by the, let's call it the $0.44 at the midpoint for the fourth quarter on let's call it the midpoint of $540 million or so. And that implies a sequential decline of about 40 bps or so from your 3.8% to about 3.4% in the operating margin line. And I guess looking back over the last couple years, sequentially operating margins have increased anywhere from 20 to 60 basis points or so historically in the June quarter. So I guess, what's driving this out of character sort of decline in operating margins in the fourth quarter?

Rich Cleys - *ScanSource, Inc. - CFO*

Yes, Tony, Rich. Couple things. One is because we didn't achieve targets for the March quarter, that has program impact in our gross margin in the June quarter. And our guidance would imply some big deals which do carry some lower margin. So on a gross margin basis, this is a little bit less than what you would have seen in the past.

Tony Kure - *KeyBanc Capital Markets - Analyst*

Okay. Is -- has pricing -- I mean, I know that's kind of abated in the past, in the last couple of quarters, especially in the December quarter, but is pricing more -- becoming more into the picture now as a pressure?

Rich Cleys - *ScanSource, Inc. - CFO*

There has been some pricing pressure and we're anticipating that to continue.

Tony Kure - *KeyBanc Capital Markets - Analyst*

Okay. Is it -- I read a thing from Ingram Micro saying -- they're claiming now to be the number two guys in the AIDC market. Is it primarily them or is it smaller guys coming in?

Mike Baur - *ScanSource, Inc. - CEO*

This is Mike. I mean, it would surprise me if they're number two, because there are some other players out there. But they could be. They don't disclose it. It'd be interesting if they would tell everybody what their revenue is.

Tony Kure - *KeyBanc Capital Markets - Analyst*

I can't prove it. That's just what they said.

Mike Baur - *ScanSource, Inc. - CEO*

But I would say that the broad-line distributors, without calling out any names, that typically operate in any of our businesses, operate at lower margins. And they're allowed to do that until the manufacturers get frustrated at their lack of investments in growing the core business. So I would say in general the broad-line business model is the one that causes us the most problems, yes.

Tony Kure - *KeyBanc Capital Markets - Analyst*

Okay. And then finally, on security, can you just talk about what sort of markets are sold into there? Is it safe to assume, is it small little retailers or is it bank branches, sort of financials? Maybe a little end market discussion there if you can, or if you even know?

Mike Baur - *ScanSource, Inc. - CEO*

Yes, sure. Well, what was interesting in this quarter in security is that -- I can't remember even if I said this, so I'll say it now -- we didn't have as many large deals. And we were disappointed, because we have had a increasing number of large projects, they call them in the security business, and led by, frankly, our IP guys and one of our newer vendors, Cisco.

And so, that was probably a little bit of a surprise for us in the March quarter, was the lack of big deals in security. And when those big deals happen -- you hit one of them -- a lot of them are banks. And they tend to be the larger enterprises. Our core business has always been business to business. None of the business that we do that we're aware of goes into residential, for example. So it's either large enterprise with big deals, or to small-to-medium across all verticals, including retail.

Tony Kure - *KeyBanc Capital Markets - Analyst*

Okay. That's all I have. Thank you.

Operator

Chris Quilty; Raymond James.

Chris Quilty - *Raymond James & Associates - Analyst*

Mike, I want to follow up a little bit on sort of the nature of the shortage you encountered. Was it vendor specific? Was it basically across all of the vendors, just because they didn't plan well and produce enough product? Or was it sort of component driven, or commodity driven, where everybody's having problems because there's a shortage of memory or something like that?

Mike Baur - *ScanSource, Inc. - CEO*

Yes, Chris, in general, from what I've heard, it's the latter, where it's there's a shortage of components. The example I heard two weeks ago from one of our vendors -- I won't say who --

Chris Quilty - *Raymond James & Associates - Analyst*

Who?

Mike Baur - *ScanSource, Inc. - CEO*

--was that an oscillator component was causing them delays in shipments.

Chris Quilty - *Raymond James & Associates - Analyst*

Ah, ha.

Mike Baur - *ScanSource, Inc. - CEO*

And so it is amazing, but it's consistent with what I have heard anecdotally from other vendors, is that when demand came back starting in September, the factories that produce their products, which they're producing not only ADC products, as we know, but cell phones and other stuff, as those -- as demand came back there was a shortage of raw components to go into the final assembly process. And as demand came back through December, it made it even worse.

And we thought we were ahead of the game on our inventory ordering. But at the end of the day, even though we had larger orders and our orders were in earlier than some others, there is a sense that most manufacturers had to be fair in their allocation of product. And so that's why we also got a little bit disappointed, if you will, with some of our allocations. And then this was across all vendors, too, to that point. There was no single vendor that jumped out at us.

Chris Quilty - *Raymond James & Associates - Analyst*

Okay. Got you. And so, at least going into that process, did you feel like you were sitting in a better inventory position than some of your competitors?

Mike Baur - *ScanSource, Inc. - CEO*

Absolutely.

Chris Quilty - *Raymond James & Associates - Analyst*

And still are?

Mike Baur - *ScanSource, Inc. - CEO*

Yes. Still are, even though I would say -- I would argue that I wanted my "unfair" share and I didn't get it, but -- but I guess they've got to give some stuff to somebody occasionally. But yes, and I think the difference, Chris, with the shortage is, in North America versus Europe, is in Europe I think we had an even bigger advantage because our competitors there are generally much smaller companies and they didn't have the financial capability to invest like we did. So I think we had a bigger advantage over our competition in Europe than in the US.

Chris Quilty - *Raymond James & Associates - Analyst*

Okay. And, Rich, anything else that we should work into the gross margins, looking ahead on a go-forward basis? I mean, you gave some color with regards to next quarter's guidance. But you don't have any other major inventory issues or pre-buys or discounts or things that might cause a swing factor?

Rich Cleys - *ScanSource, Inc. - CFO*

In the gross margin?

Chris Quilty - *Raymond James & Associates - Analyst*

Yes.

Rich Cleys - *ScanSource, Inc. - CFO*

I mean, it'll be volume driven. So I mean, we -- this last quarter we had some benefits on our gross margin. So let me just kind of walk you through the EPS reconciliation and maybe this will help you looking forward, too. So we -- if you look at what our guidance was, we guided to $0.46 at about $545 million. We missed our volume by about $0.12, but customer mix, which is fewer large deals, rebates and programs, as well as some benefits on freight, frankly, gave us about $0.08 to offset that $0.12. So we only missed our margin by about $0.04 a share.

What we did do -- and this is not to your margin point -- but what we did do is we had some favorable bad debt expense against our expectations, because we actually had some recoveries this quarter. So that brought us back about $0.03 going the other way. So as we perform this quarter with the lower sales, the programs are going to affect us. I mentioned some of the price pressure that we see out there. And by and large, that's what we'd be looking at for the -- going forward.

Chris Quilty - *Raymond James & Associates - Analyst*

Very helpful. Thank you, guys.

Operator

(Operator instructions.) One moment, please. Ajit Pai; Thomas Weisel Partners.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Yes. A quick question on the operating margins. Just looking at the fact that you highlighted that your operating margins are so much significantly higher than the broad-line distributors and the fact that you also invest more in the business. Back in '02 your margins had gone down and then they rebounded very nicely over the next few years. Currently when you're watching your margins go down, is there anything that's structural that is indicating your industry is becoming more competitive and they won't bounce back to prior highs? Or do you think that there's no reason why they shouldn't come back to prior highs? And that's looking at also the mix of international and the mix of security in your business.

Mike Baur - *ScanSource, Inc. - CEO*

Ajit, this is Mike. Let me just tackle one piece of it and then see if Rich wants to chime in. I mean, I would say don't forget that, as we've always said, whenever margins are at the high end of 3's and low 4's, we view that as an indicator that we should be making investments. So if we think about the investments we made in 2009 in the recession and continue to do in 2010, they are -- we are expanding European communications. So that is a business opportunity which, for us, that's code that means it's going to run below normal operating margins. Okay? Because we feel like we can invest, get our infrastructure right, and be prepared to grow significant revenues over there. So that's number one.

Number two, still investing in security. So, again, at lower than mature operating margins, okay? And then, in Catalyst, for the first time we're making investments because of the Nortel opportunity.

And so those three things are going on right now that are a part of the reason why you won't -- you shouldn't expect to see that margin pop up unless there's just some unusual volume contribution. Okay?

Ajit Pai - *Thomas Weisel Partners - Analyst*

Got it. But over time, you don't see any structural change in your business, that margins are going to stay lower? There's no reason why over time they won't trend up into sort of the high 3's and low 4's. Right?

Mike Baur - *ScanSource, Inc. - CEO*

That's kind of what our history has been. Right.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Right. And there's nothing you've seen that is changing the industry dynamic right now?

Mike Baur - *ScanSource, Inc. - CEO*

No. The answer to that is nothing has changed to change that. Correct.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Got it. The second is, you did talk about the fact that your receivables have been fairly prudent and managing your risk, et cetera, over there. But in terms of color, I know you've made some collections unexpectedly that provided you $0.03 in this quarter. But from a broad perspective, both in terms of your relationship with your lenders and then your relationship on the receivables side with the value-added resellers and your customers, are you seeing the quality of credit and availability of credit to you improve and -- for you folks? As well as, when you're lending, are you looking at the default rate or the amount of -- the terms that your customers want from you, is the pressure -- are you being relieved of the pressure or is the pressure still pretty high?

Rich Cleys - *ScanSource, Inc. - CFO*

Well, let me answer, because that's on both sides. So our ability to borrow -- we have -- we've got a -- our primary borrowing facility is a revolver and we negotiated a five-year revolver. So that revolver goes through 2012. And we have $250 million available on that revolver. It's led by JPMorgan. We've got a very strong bank group. And frankly, our business model is one that we think the banks like, because when times got tougher, we paid down debt, because we liquidated receivables and inventory. And then when things start to get better, then we start to borrow. So we've got a good profile and I believe that our availability to cash is as strong as it's ever been. And we have a strong a balance sheet as we've ever had.

Now for the customer's side, we continue to utilize the same underwriting policies and techniques that we have in the past. We're very aware of the environment that our customers are working in. We know that some of our customers have come out of this recession with weakened balance sheets. And we work very closely with them to be able to continue to sell product to them. But there are some, as you can see by our bad debt reserve, that we've increased some of our risk coverage with the bad debt reserve. But our performance overall on the receivables, if you look at receivable base and if you look at our overall performance, when I talk about bad debt expense, it's still pretty good. So we're feeling that we shouldn't cut back. We shouldn't really change our underwriting. We're still very, very [pro] with our customers, so.

Ajit Pai - *Thomas Weisel Partners - Analyst*

So that would mean that you haven't cut off customers because of their credit. So far the kind of underwriting polices that you had in analyzing risk haven't changed at all over the past couple of years?

Rich Cleys - *ScanSource, Inc. - CFO*

Our underwriting policies are the same and we probably have more customers today than we had a year ago. I know this quarter we have more customers than we did the quarter before.

Ajit Pai - *Thomas Weisel Partners - Analyst*

Got it. Okay. Thank you.

Operator

Gregory Macosko; Lord Abbett.

Gregory Macosko - *Lord Abbett - Analyst*

Yes. Just one question. I just wanted to understand the shareholders' equity, the accumulated other comprehensive income. That shifted quite a bit. It's still small, but could you just explain that, what that line is?

Rich Cleys - *ScanSource, Inc. - CFO*

Are you looking at the inclusion of the accumulated exchange reserve, which we've got exchange rate changes?

Gregory Macosko - *Lord Abbett - Analyst*

Okay. That's for the exchange rate?

Rich Cleys - *ScanSource, Inc. - CFO*

Yes. That's the biggest piece.

Gregory Macosko - *Lord Abbett - Analyst*

Okay. So that can swing a fair amount over the year, then?

Rich Cleys - *ScanSource, Inc. - CFO*

Right. Right.

Gregory Macosko - *Lord Abbett - Analyst*

Okay. Thanks very much.

Operator

And I show no further questions at this time.

Mike Baur - *ScanSource, Inc. - CEO*

Very good. Thanks, Jared. Thank you joining us. A replay of this call will be available in one hour on the ScanSource, Inc. website. A full transcript of this call will be available in 24 hours. To access the replay or transcript, visit the Investor Relations tab on the ScanSource, Inc. website. This information will be available until our next earnings call.

Our next conference call to discuss the June 30th quarterly and full-year earnings is expected to be on August 19th, 2010.

Again, thank you for joining us today.

Operator

That concludes today's conference. Thank you for your participation. You may disconnect at any time.