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SCSC.OQ - Q4 2021 Scansource Inc Earnings Call

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PRESENTATION

Operator

Welcome to the ScanSource quarterly earnings conference call. (Operator Instructions). Today's call is being recorded. (Operator Instructions).

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

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

Good afternoon, and thank you for joining us. Joining me on the call today are Mike Baur, our Chairman and CEO; John Eldh, our Chief Revenue Officer; and Steve Jones, our Chief Financial Officer. We will review our operating results for the quarter and fiscal year and then take your questions. We posted a CFO commentary that accompanies our comments and webcast in the Investor Relations section of our website.

Let me remind you that certain statements in our press release and the CFO commentary and on this call are forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from such statements. These risks and uncertainties include, but are not limited to, those factors identified in the earnings release we put out today and in ScanSource's Form 10-K for the year ended June 30, 2021, as filed with the SEC. Any forward-looking statements represent our views only as of today and should not be relied upon as representing our views as of any subsequent date.

ScanSource disclaims any duty to update forward-looking statements to reflect actual results or changes in expectations, except as required by law. During our call, we will discuss both GAAP and non-GAAP results and have provided reconciliations between these amounts in the CFO commentary and in our press release. These reconciliations also can be found on our website and have been filed with our Form 8-K.

I'll now turn the call over to Mike.

Michael L. Baur - *ScanSource, Inc. - Founder, Chairman, CEO & President*

Thanks, Mary, and thanks, everyone for joining us today. Each quarter of our fiscal year, I've shared with you our consistent execution and strong momentum in driving our strategic plan. For our fourth quarter, we achieved outstanding sales and profitability growth. Throughout the fiscal year, we built back our sales volumes and our fourth quarter sales of \$853 million topped our pre-COVID sales levels. For the fourth quarter, operational excellence by our employees drove the achievement of 34% year-over-year net sales growth and a non-GAAP EPS of \$0.96. During fiscal year 2021, ScanSource has demonstrated that our hybrid distribution model is winning in the marketplace. Our talented team of sales, marketing and engineering professionals create hybrid solutions that allow our channel partners to meet the technology demands of end-user customers. We are enabling our channel partners to accelerate their transformation to an exciting and fast-growing digital world of opportunity.

Due to our specialized expertise, ScanSource is uniquely positioned to capitalize on the massive marketplace shift to cloud, X, which is everything as a service, and subscription-based models. John, in a few minutes will describe some of the ways our channel, both sales and supplier partners, are delivering innovative value to end-user customers across many different markets. We are gaining market share from competitors, while creating demand for new opportunities that require our specialized expertise.

As we transition from the impacts of COVID on our business during FY '21, we are prepared for the business opportunities ahead. Our team of highly motivated and immensely talented professionals will make a difference as we tackle the year ahead. Our successes in FY '21 were achieved because our people strengthened their relationships with long-standing customers and gained new customers as well.

I will now turn the call over to John to discuss our business performance.

John Charles Eldh - ScanSource, Inc. - Chief Revenue Officer & Senior EVP

Thanks, Mike. Q4 was a strong finish to an impressive year of improving results. Our team achieved 34% year-over-year sales growth and the second highest quarterly sales performance in ScanSource's 29-year history. I'm excited by the continued energy and momentum across our business as evidenced by the broad-based sales and profitability growth we delivered in Q4. Our growth was fueled by strength in big deals, taking share from competitors, increasing wallet share with our existing customers and adding new customers.

Our fourth quarter results reflected operational excellence by our employees throughout the business as we navigated a challenging and supply-constrained environment. Our teams delivered outstanding partner and supplier experiences and proved our ability to exceed partner expectations.

In our Barcode, Networking & Security segment, net sales increased 34% year-over-year and 19% quarter-over-quarter, led by strong market demand, especially in mobility. With increased demand and continued labor shortages, end customers are implementing mobile computing solutions to increase worker productivity.

With the reopening of Main Street, our payments business, which has a higher margin profile from wrapping margin-rich services around hardware, rebounded well. We saw accelerated demand from more complex and innovative offerings to support curbside pickup and pay-at-the-table.

Within our Communications & Services segment, we grew net sales 35% year-over-year and 12% quarter-over-quarter. For our unified communications business, the growth in cloud-enabled endpoints accelerated by the shift to cloud, outpaced the decline in premise-based communications. The hybrid office and remote work trends are proving significant opportunities for our UCaaS, CCaaS, cloud-enabled endpoints and connectivity solutions.

In our SaaS business, we achieved double-digit sales growth across North America, Brazil and intY U.K., and we continue to invest in people ahead of revenue.

Impressively, our Intelisys business, the leader in the industry, crossed the \$2 billion mark in ARR, annual recurring revenue. This is billings by suppliers to end users. This number is up from \$700 million 5 years ago when we acquired Intelisys. Year-over-year, Unified Communications as a Service grew 19.5% and Contact Center as a Service grew 68%. Overall, it was another record quarter for Intelisys, achieving 13% year-over-year growth. This marks our 20th quarter in a row of double-digit growth.

Given our heritage and leadership position in premise-based communications, we are uniquely positioned to capitalize on this technology shift to the cloud. We are enabling our 2,000 on-premise communication VARs to transform their businesses to take advantage of cloud opportunities, subscription and recurring revenue.

Each quarter of our fiscal year, including Q4, our team in Brazil has delivered consistent performance on both top line revenue and profitability through strong financial discipline. We experienced strength in big deals and increased market share with strong double-digit growth across

barcode and mobility, cybersecurity and digital workplace solutions. In addition to our success across hardware, our business in Brazil continues to build outstanding momentum across SaaS and cloud solutions.

We're on a journey to identify and address end-user technology buying and consumption patterns. We've been expanding on our capabilities organically and through acquisitions to enable our partners to meet these end user requirements.

As a leader in hybrid distribution, we are accelerating the future of technology for our partners across hardware, software, connectivity and cloud. Fundamental to our strategy is alignment with our suppliers and sales partners to understand the ever-changing requirements of our markets. With this market knowledge we've developed deep, specialized expertise in suppliers, technologies, and end-user buying preferences. Around these, we've built some of the industry's most impactful services and programs to enable our partners' success.

Because of our success in hybrid distribution, suppliers look to ScanSource to help solve their most complex go-to-market challenges. As an example, in June, we announced our expanded relationship with Cisco, to help them unlock new opportunities for growth in UC, cloud and recurring revenue across our Intelisys channel.

As a part of our commitment to partner success, we lead in enabling our partners to thrive in today's digital world. In FY '21, we hosted an unprecedented 450 marketing events focused on the skills, technologies, talents and business opportunities needed for success in this new age.

I'm also excited about key leadership changes we've made. In August, Tony Sorrentino, a 22-year ScanSource veteran and expert in hardware distribution and channels was promoted to President of our North America hardware business, and will lead the merging of hardware distribution and services for our next phase of growth. A few weeks later, we announced a 26-year channel veteran and expert in cloud services and channels, John DeLozier, joined us as President of Intelisys. John is a longtime supporter of the channel who is laser-focused on partner and supplier success, including uncovering new opportunities for growth. The collective expertise and experience that Tony and John bring to the channel in hardware and cloud services will help us accelerate and scale our hybrid distribution growth strategy.

In summary, we are excited about our Q4 performance, the strength and momentum of our business and the opportunities that lay ahead. I also want to send out a massive thank you to all of our employees and all of our partners for their commitment, dedication and loyalty to ScanSource and our joint success.

Now Steve will take you through the financial results.

Stephen T. Jones - ScanSource, Inc. - Senior EVP & CFO

Thanks, John. Our strong fourth quarter results demonstrate our team's successful execution of our strategic plan. We have proven our ability to drive top line growth in the midst of COVID and industry-wide supply chain challenges. Our fourth quarter net sales of \$853 million increased 34% year-over-year and 17% quarter-over-quarter. It's significant that this growth was broad-based across our technology segments and geographies. Our gross profits grew 29% year-over-year to \$96 million. Sales mix, including large deals contributed to a gross profit margin of 11.2% and compared to 11.7% for prior year's quarter.

Our non-GAAP SG&A expense for the quarter of \$64.5 million increased \$1.9 million or 3% year-over-year, which includes investments in strategic headcount for Intelisys and other growth areas. Non-GAAP EPS for the quarter of \$0.96 and improved -- our non-GAAP EPS for the quarter was \$0.96 and improved each quarter of our fiscal year. Our fourth quarter income tax includes a benefit from discrete tax items related to our international operations, primarily Brazil of \$4.9 million or \$0.19 per diluted share. For fiscal year 2022, we estimate the effective tax rate to range from 25% to 26%, reflecting Brazil's tax items and geographic mix.

Now turning to the balance sheet and cash flow. We had strong operating cash flow for the quarter of \$61 million and for the year of \$117 million. Year-over-year, we reduced working capital investment by \$40 million, a 10% year-over-year decline and strengthened our balance sheet. Q4 DSO came in at 60 days, an improvement from the previous year and quarter of 63 days and in line with our expected range. Our Q4 inventory turns of

6.5x are faster than our typical range as we navigate through industry-wide supply chain constraints. On June 30, 2021, we had cash and cash equivalents of \$63 million and debt of \$143 million.

Our net leverage totaled approximately 0.7x trailing 12-month adjusted EBITDA. While our top capital allocation priority remains investing in growth opportunities to drive long-term value, we are announcing a new \$100 million share repurchase authorization reflecting our confidence in ScanSource's business and the strength of our long-term cash flow generation.

And finally, for the fourth quarter FY '21, our return on invested capital increased to 14.9%, the highest quarterly ROIC in over 5 years.

I would now like to turn the call back over to Mike for closing comments and annual outlook.

Michael L. Baur - ScanSource, Inc. - Founder, Chairman, CEO & President

Thanks, Steve. In a press release earlier today, we announced the retirement of longtime director, Jack Reilly, and the appointment of Charlie Mathis to our Board of Directors. This is a well-deserved thank you to Jack for 20 years of service and a welcome back to the company for Charlie. From 2012 to 2016, Charlie served as ScanSource CFO, and he was instrumental in crafting the strategy that resulted in our Intelisys acquisition.

As we exit FY '21 with such momentum, we are increasingly more confident of the growth and valuation creation opportunity ahead for ScanSource. In the past, we have provided quarterly financial guidance, and we were always explaining to our investors that our hardware distribution business works with limited visibility without bookings or backlog. However, with the change in our business to a hybrid model, where we have more recurring revenue each year, and the growing attach rate of our services and software to our hardware sales, we have decided to provide an annual outlook for the first time.

For fiscal year 2022, we expect our year-over-year net sales growth to be at least 5.5%, and we expect adjusted EBITDA to be at least \$135 million. This compares to last year of \$118 million.

Finally, we are pleased to announce our \$100 million share repurchase authorization that reflects the Board's continued confidence in our strategic plan.

We will now open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Keith Housum of Northcoast Research.

Keith Michael Housum - Northcoast Research Partners, LLC - MD & Equity Research Analyst

Good afternoon, guys, and great job. Question for you on the inventory levels. Inventory levels were roughly equal to last year, which seems kind of surprising based on the supply constraints that we're seeing over the overall market. Can you talk to the quality of your inventory levels and any insight you have in terms of the supply chain constraints as you look into the first quarter?

John Charles Eldh - ScanSource, Inc. - Chief Revenue Officer & Senior EVP

Yes. Keith, thanks for your question. Good to hear your voice. I think as it relates to supply chain, look, I would have to say that I'm really pleased with the work we've done and what we've had to do to navigate the environment over the past several quarters. And I have to hand it to our sales and our -- kind of our supplier services and purchasing teams for doing what I really think it was an outstanding job dealing with the environment. We managed inventory well over the past 2, 3 quarters, and I believe that we'll be able to continue to navigate the environment moving forward.

Keith Michael Housum - Northcoast Research Partners, LLC - MD & Equity Research Analyst

Great. Now would you say that your sales were impacted by your inability to obtain any product?

John Charles Eldh - ScanSource, Inc. - Chief Revenue Officer & Senior EVP

Not really, nothing that -- negligible if anything.

Keith Michael Housum - Northcoast Research Partners, LLC - MD & Equity Research Analyst

Got you. And then you guys haven't issued guidance for probably the second quarter of 2020, if my memory is correct. Would you say that you guys have increased, I guess, confidence in your ability to forecast because I think that was 1 of the issues you guys were citing as -- why you didn't provide guidance.

Michael L. Baur - ScanSource, Inc. - Founder, Chairman, CEO & President

Keith, it's Mike. Yes, we certainly spent a lot of time over the last few quarters, making sure we can understand what is driving our growth for the last 4 quarters and going forward. And we really believe we've gotten a significant advantage now having recurring revenue become a bigger part of our business and the attachment of recurring revenues, services, software to hardware makes that transaction stickier than it was in the past. So we believe we have more confidence.

And then secondly, if you remember, we really restructured the sales organization 1.5 years, 2 years ago. And I think what John and his team have done this past year to better develop a relationship both in a transactional basis, but more importantly, strategic so that our customers are spending a lot more time talking to us about their planned purchases, where they're going to grow, what areas. And this relationship that has really dramatically changed over the last year is also enabling us to do our business more efficiently, back to your inventory question.

And so we have better knowledge of what our customers see coming than ever before. And I think that's a big change in what gives me a lot more confidence. It still doesn't mean just for the record that we're going to have this thing perfectly done. This is our attempt at a longer-term outlook. We believe quarterly was just always really hard and still can be because we still will have some seasonality in our business. But we believe providing this first annual outlook, which, by the way, we'll update quarterly, will be a way for us to show our confidence in our business.

Operator

Our next question comes from Chris McGinnis of Sidoti & Company.

Christopher Paul McGinnis - Sidoti & Company, LLC - Special Situations Equity Analyst

Thanks for taking my questions and nice quarter. Can you just touch on the market share gains you talked about. Is that sustainable? And what's driving that? Is it the offering or the ability to get supply? Can you just dive into that a little bit more? Thank you.

John Charles Eldh - ScanSource, Inc. - Chief Revenue Officer & Senior EVP

Yes, Chris, this is John. Thanks for the question. Yes, the market share gains -- first of all, I do think they are absolutely sustainable. COVID really was kind of an ignition point for digital transformation initiatives, as you know, all across the business. And we play in many of the markets, large and growing that impact people's path to digital. And so yes, we had some wins because we had some inventory, which is great. But more so than that, we took share. We drove big deals, and we were able to execute really, I think, in large part, too, some of the things Mike talked about in the reorganization of the sales organization 1.5 years, we're really driving tighter, better and more aligned relationships with both our sales partners and our suppliers and building deep, meaningful relationships that are driving to joint success. So we're pretty excited, and we feel good about '22.

Christopher Paul McGinnis - Sidoti & Company, LLC - Special Situations Equity Analyst

Great. And if I remember, I don't think it was last quarter, maybe 2 quarters ago, you talked about POS Portal having some issues in the market. Has that come back? And can you give a level of growth that you're seeing from that business?

John Charles Eldh - ScanSource, Inc. - Chief Revenue Officer & Senior EVP

Yes. We -- you heard me talk in my prepared remarks about the reopening of Main Street. And we are -- we continue to be excited by that business. Obviously, in the early days of COVID, we were impacted greatly because Main Street shut down. But as it began to reopen, we saw our revenues, our attach rate with services and our volumes increase. And actually, now we're back to pre-COVID levels. And so we're very excited about that business. And if you remember, that business is a business that drives higher margins for us due to services that we wrap around the hardware. And so we're excited that Main Street is open, and we are definitely back in business there.

Christopher Paul McGinnis - Sidoti & Company, LLC - Special Situations Equity Analyst

And then just last question, just on the new share authorization. You just -- do you expect to be active on that relatively soon? Or is there opportunities maybe for M&A when you look at the strength of the balance sheet and the cash flow?

Stephen T. Jones - ScanSource, Inc. - Senior EVP & CFO

Yes. Chris, this is Steve Jones. Thanks for the question. So I would say that our first priority is always going to be to look for those long-term value creation opportunities, and that would be around growth, both organic and in our M&A opportunities. So that would be our top priority.

Operator

(Operator Instructions). I'm showing no further questions at this time. I'd like to turn the call back over to Mike Baur for any closing remarks.

Michael L. Baur - ScanSource, Inc. - Founder, Chairman, CEO & President

Great. Thank you for joining us today. We expect to hold our next conference call to discuss September 30 quarterly results on Tuesday, November 9, 2021.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may all disconnect. Have a great day.

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