MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Ryan and I will be your conference operator today. At this time I would like to welcome everyone to the SYNNEX fiscal 2010 Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. [Operator Instructions]

Thank you. I will now turn the call over to Ms. Laura Crowley.

Laura Crowley, Director of Investor Relations and Public Relations

Thank you, Ryan. Good afternoon and welcome to the SYNNEX Corporation fiscal 2010 second quarter earnings conference call. Joining us on today's call are Kevin Murai, President and Chief Executive Officer; Dennis Polk, Chief Operating Officer; Thomas Alsborg, Chief Financial Officer and Chris Caldwell, Senior Vice President, Global Business Services.

Before we begin, I would like to note that the statements on today's call which are not historical facts may be forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These forward-looking statements include, but are not limited to statements regarding our strategy including growth, profitability and return, expectation of our revenue, net income and diluted earnings per share for the third quarter of fiscal 2010, our performance, impact of our joint venture investment, general economic recovery, the integration of Jack of All Games and market conditions. These are subject to risks and uncertainties that could cause actual results to differ materially from these discussed in this forward-looking statement.

Please refer to today's press release and documents filed with the Securities and Exchange Commission. Specifically, our most recent Form 10-Q for information on risk factors that could cause actual results to differ materially from those discussed in these forward-looking statements. Additionally, this conference call is the property of SYNNEX Corporation and may not be recorded or rebroadcast without specific written permission from the Company.

Now, I'd like to turn the call over to Thomas Alsborg for an update on our financial performance. Thomas?

Thomas Alsborg, Chief Financial Officer

Thank you, Laura. Good afternoon, everyone and thank you for joining our call today. I'll begin by summarizing our results of operations for the quarter with our key financial metrics and then we'll provide our guidance for the fiscal third quarter.

In our second quarter 2010, which ended May 31st, total consolidated revenues were 2.33 billion up 5% sequentially and consistent with our recent upwardly revised Q2 estimates. Compared to the year-ago quarter, this represents a 12.8% increase in revenue, an impressive achievement especially when one considers that Q2 2010 includes net revenue accounting presentation of $90 million for certain service and extended warranty contracts.

This net revenue accounting presentation was introduced and discussed at length during our Q1 2010 earnings call. And just for comparative purposes, to illustrate the demand and our market share performance, on an apples-to-apples gross revenue basis with the prior year same quarter, our revenue would have reflected a 17.8% increase before the netting of the 90 million in sales, and our net income profitability reflects this.

Our first quarter net income from the continuing operations was $24.8 million or $0.70 per diluted share, surpassing Wall Street estimates of $0.68 and return on invested capital was 9.2% for the fiscal second quarter of 2010, extending our virtual string of year-over-year quarterly growth and ROIC to 11 quarters.

From a product perspective, our mix of business continues to be healthy. From an end-market standpoint, demand was pervasive. March and April were particularly strong months fueled by pent-up demand as we came out of the recession.

Demand in the SMB and federal government and retail end markets was particularly good throughout the quarter, though retail was impacted by some shortages and state and local government spending was not as strong as usual. Overall, Q2 was a very strong quarter with above normal growth.

In the second quarter of fiscal 2010, our consolidated gross margin expanded to 5.74%. This represents an increase of 10 basis points sequentially. Once again, our core distribution business contributed to our sequential increase in gross margin. These improvements are the results of continued strength and improved mix driven by our growth initiatives as well as operational execution and strong cost control.

Second quarter 2010 selling, general and administrative expense was 73.2 million or 3.60% of revenues compared to 70.9 million in the second quarter of fiscal 2009, and 70.2 million or 3.63% sequentially. This reflects a good SG&A leverage and continued discipline in cost management on the part of SYNNEX management.

Operating income from continuing operations was 43.4 million or 2.14% of revenues for the fiscal second quarter, compared to 30 million in the prior year, and 39.0 million or 2.01% of revenues in the fiscal first quarter of 2010.

The net total interest expense and finance charges for the second quarter of 2010 was $3.7 million, an overall increase from the prior year quarter of 4.2 million, mainly due to lower interest – excuse me, overall decrease, mainly due to lower interest rates and lower levels of borrowing.

Our net total interest expense has benefited in recent years from the income from financing of a large Mexico contract, which is winding down this year. The net impact to 2010 would be about $0.07 to the extent it is not offset with more such deals in the future, in which case we would expect to see some of this reflected in the net higher interest expense moving forward.

Other expense for the second quarter of 2010 was approximately $93,000 compared to other income of $1.4 million in the same quarter last year. The prior-year other income of $1.4 million resulted from gains in our deferred compensation investments offset in part by some FX losses.

The effective tax rate for the second quarter of fiscal 2010 was 37.0%, compared to 36.5% in the second quarter of 2009. The increase in effective tax rate for the quarter was primarily due to an approximate $400,000 prior-year tax audit settlement during the quarter.

Turning to the balance sheet; our accounts receivable totaled 733 million at May 31, 2010, down from 782 million in the first quarter of 2010. DSO was 38 days. Inventory totaled $792 million at the end of the second quarter, compared to 771 million in the first quarter of 2010, translating to 38 days of inventory supply, and reflecting the impact of timing of receipts versus related shipments as the quarter ended, as well as our continued transitioning of the Jack of All Games inventory. Days payable outstanding was 34 days. Hence, our overall cash conversion cycle for the second quarter was 42 days, down from 45 days in Q1 2010.

Our debt to capitalization ratio reached another historic low level of 24%, down from 27% in Q1 2010. Our liquidity and access to cash remains excellent. At the end of Q2, the company had over $370 million available between cash and its working capital lines.

Other financial data and metrics of note are as follows. Second quarter depreciation expense was $2.8 million. Amortization expense was $1.3 million. Hewlett-Packard had approximately 38% of net sales was the only vendor accounting for more than 10% of sales during the quarter – second quarter of 2010. Capital expenditures were $2.4 million for the second quarter. Preliminary cumulative year-to-date cash flows used by operations was approximately $13 million.

Moving to our third quarter 2010 expectations; for Q3 2010, our revenue will be affected by the following changes to our business: First, consistent with the prior two quarters, our net basis accounting for certain services and extended warranty contracts will be reducing sales by approximately 85 to $95 million compared to a gross basis reporting.

As we anticipated in our January earnings call, one of our customer contracts is now being transitioned, such that we will be providing our customer certain services on a fees only basis, which will account for 25 to 35 million in lower revenue in Q3.

And third, also, we recently agreed to invest, at approximately $3 million which represents our book value, a small unit of our business called NDS into a joint venture in which we will have a minority interest. This will have a small impact to Q3 revenue of about $5 million, and to net earnings an impact of about $100,000. This will be reflected in our GBS business going forward.

As a result of these three foregoing items, our Q3 2010 revenue is being setback by approximately 115 to $135 million, though most of the normal profit associated with these revenue streams will remain in the business. Therefore, given the cumulative effect of the aforementioned top line changes and given the current market environment, we are estimating our revenues will be in the range of 2.05 billion to $2.15 billion.

This forecast reflects continued economic recovery with IT demand recovering at slightly more modest levels than we've seen in the past few months. Nevertheless, on an apples-on-apples basis, we expect that the core distribution business will grow in the double digits on a year-over-year basis.

Turning now to income and EPS, our forecast for net income is expected to be in the range of 25.8 million to $26.8 million, and diluted earnings per share is anticipated to be in the range of 72 to $0.75 per share. The calculation of diluted earnings per share for the second quarter is based on a diluted weighted average common share count of approximately 35.9 million shares.

As a reminder, all of these statements are forward-looking and actual results may differ materially. I will now turn the call over to Kevin Murai for his perspective on the business and our quarterly results. Kevin?

Kevin Murai, President and Chief Executive Officer

Thank you, Thomas. Good afternoon to everyone and thank you for joining our call today. Before I discuss the business, I would like to draw your attention to the announcement we made today regarding the retirement of Bob Huang, SYNNEX's Founder and Chairman of the Board. Over the past 30 years, Bob has been the inspirational leader of SYNNEX, taking it from startup to an $8 billion public company.

Few leaders can make the transition from entrepreneur to a Fortune 500 CEO, but Bob has done an extraordinary job in making SYNNEX a leader in our space. The legacy Bob leaves behind is a team of the most talented people in our industry and a culture where hard work and winning is contagious. I wish Bob the very best in his future endeavors.

I also want to congratulate Dwight Steffensen on his appointment to Chairman of the Board. Dwight has been a member of our Board of Directors since 2002 and most recently was our Lead Director. His business acumen and extensive experience will serve SYNNEX well, and I look forward to working with Dwight going forward.

Now back to our second quarter. Once again, the SYNNEX team performed exceptionally well. With the completion of our second quarter, I feel confident about the market, and we're on top of our business as we head into the rest of 2010. The U.S. market continued to show above normal growth even in our seasonally soft Q2 period. Q2 was aided by the release of some pent-up demand and an ongoing product refresh.

With this as a backdrop, we continue to make gains in our growth initiatives which affected a healthier mix of business. Specifically, we achieved robust growth in our enterprise business, SMB, our consumer electronics business, and our specialized business units such as wide format print and managed services. In addition, we gained share in many of our product categories. This resulted in growth and profitability that was above our initial expectations in March and another strong quarter of ROIC.

Our consumer electronics business continues to do well quarter-after-quarter and we continue to gain momentum in this estimated $180-billion industry segment where SYNNEX is now a leader in the North American consumer electronics market. We're in the midst of completing the integration of the Jack of All Games business. We anticipate the integration and the full business transition along with our positioning for targeted synergies to be complete this quarter, in time for the seasonally high Q4 period.

Canada's economic recovery gained strength during the second quarter as we experienced positive momentum. I'm pleased with the Canadian team's performance as they continue to produce impressive results on earnings and ROIC. Our Global Business Services segment continued to make good progress this quarter as we grew most of our accounts at higher than market rates and continued to launch new pilot programs for existing and new customers.

GBS operating income from continuing operations was up 17% year-over-year. ROIC, once again, met our double-digit criteria. And we continue to build out our own proprietary platform solutions which will increase our value proposition to customers and allow for more leverage in our earnings over time. We see multiple areas of growth for 2010 for GBS and will continue to leverage our relationships with our vendor partners on the distribution side to expand this business.

So in summary, we posted yet another exceptional quarter of higher than normal growth and with improving and leading profitability and returns. We continue to maintain our competitive advantages in our low cost model, our customer service, and more importantly, the innovation we apply to the way we go to market. We remain optimistic about 2010 and the overall demand environment. And while the market will obviously not maintain the exceptional growth of the last two quarters indefinitely, we're doing well to capitalize on it by capturing share in key target markets benefiting our mix of business and growing profits and returns. We're very pleased with our progress to-date and our position heading into the remainder of fiscal 2010.

Turning to the third quarter, our success of Q3 2009 and Q2 2010 has resulted in tough compares. But with continued market demand stability and the aforementioned good progress on our growth initiatives under our belt, we're confident in our future and our prospects look good. Generally, we see good stable demand in SMB and retail in particular, so current weaker demand in state and local government is an isolated factor to contend with as the third quarter is usually up seasonally for this sector. As pent-up demand for PCs benefited us in the past few months, we see opportunities with product refreshes driven by Windows 7, and the recent launch of Office 2010 which will be beneficial during the second half of 2010.

In summary, our third quarter guidance reflects a realistic assessment and our confidence in continued profitable growth in both our core distribution segment and our GBS segment.

Before I open the call for questions, I'd like to recognize and thank the SYNNEX team for their continued hard work, dedication and relentless focus on improving all aspects of our business. This team is very capable of rising to the occasion, quarter-after-quarter, to position SYNNEX in our leadership role. I'd also like to thank our customers and suppliers for their continued business and support. Our success is also attributed to their continued support.

And on a final note, with the completion of our second quarter of 2010, SYNNEX achieved our 92nd consecutive quarter of profitability, continuing our strong track record of achieving our core operating and financial objectives, a constant focus for the organization. SYNNEX continues to demonstrate its leadership by increasing our value within the supply chain through creativity and innovations that help our customers and vendors be more successful. This leadership performance has translated to increased market share, margin and profit expansion, very healthy EPS growth and a virtual string of 11 straight quarters of year-over-year ROIC growth, with current trailing 12-month ROIC at 9.5%.

Thank you again for your time today and for your continued interest and investment in SYNNEX. Laura, let's now turn the call back to the operator for questions.

Laura Crowley, Director of Investor Relations and Public Relations

Thank you, Kevin. Ryan let's go ahead and open up the line for questions, please.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]. Your first question comes from Craig Hettenbach with Goldman Sachs.

<Q – Craig Hettenbach>: Yes. Thank you. In the prepared remarks you comment that March and April were particularly strong, didn't say much about May. And then you also commented that the IT demand might be a little more moderate in terms of the pace. So I was just hoping you could just elaborate on those comments there in terms of what you're seeing out there in the IT spending environment?

<A – Kevin Murai>: Sure, Craig. We started off not just the beginning of the quarter but the beginning of the year with exceptional growth, a lot of it driven by what we believe to be pent-up demand through much of the recession last year. We saw that pent-up demand being released from the beginning of the year primarily in the refresh cycle of PCs that we certainly benefited from.

Now, as we got through the quarter, we continued to see good recovery coming out of the recession and strong fundamental demand. But as we entered the latter part of our quarter, we also experienced some level of product shortages in certain parts of our business, and specifically shortages in televisions, there were some shortages in network equipment as well as shortages in printer consumables.

<Q – Craig Hettenbach>: Okay. And if I could follow-up, Kevin, could you just discuss the traction, the enterprise market and just how you see that business ramping in the second half of the year?

<A – Kevin Murai>: Sure. And just to refresh for everybody, the enterprise server and storage space has been a focus growth area of SYNNEX for the past couple of years now. And as we continue to gain more and more traction and gain market share in that space, perhaps some of what we see maybe slightly better than what the overall market is doing. We are seeing that market overall starting to come back, but I think our performance there has been much stronger than what the overall market is. So we continue to grow significantly, in particular in the server end of that business. And from an enterprise storage perspective, we're also growing much faster than market as well.

<Q – Craig Hettenbach>: Okay. And then last one, just on the competitive and pricing environment, the gross margin performance look good, any other comments on what you're seeing out there in pricing?

<A – Kevin Murai>: Yeah, I would tag it as normal, relatively muted. I think that we continue to manage well in just a fundamentally competitive environment, but certainly no more competitive than it has been in the past.

<Q – Craig Hettenbach>: Okay. Thank you.

<A – Kevin Murai>: Thanks, Craig.

Operator: Your next question comes from Brian Alexander with Raymond James.

<Q – Brian Peterson>: Hi, this is Brian Peterson in for Brian Alexander. Just following up on Craig's question, it looks like that you guys finished at the high end of your guidance. Well when you revised it at the Analyst Day, you had said that you would be coming above the high end of guidance. So just trying to get some incremental clarification on what changed, was it shortages that intensified or was it demand that softened, just some incremental clarification.

<A – Kevin Murray>: Yeah. I think it was probably a combination of a number of things, although any one particular thing I don't think by itself was a significant issue. Product shortages is the one that we called out. We do believe that the pent-up demand that we have seen driving, what I would call exceptional growth through the first part of the year has worked itself through the market for the most part.

But I think the important note here is that the strength in IT demand continues to happen. I think that the high single – or the high double-digit, the high teens growth that we've seen, we certainly don't expect to continue throughout the entire year. But fundamentally, the market is very strong, demand continues, and I think it was just the combination of some pent-up demand flowing through and some level of product shortages that caused May to be somewhat softer.

<Q – Brian Peterson>: Fair enough. Looking at – you called out three items that are going to be impacting top line results, I believe you said 115 to 135 million. Just a clarification, how much of that is incremental on a sequential basis? Because the net accounting should have been in your second quarter results, so just trying to get what's the sequential impact.

<A – Thomas Alsborg>: Sure. Brian, this is Thomas. And in the first quarter our net revenue was about $75 million. This time it was a little over $90 million. So it's about a $15 million differential there. Then you add to that the 30 million called out for our customer. That is our vendor that we're going to a fee basis and then another five million for NDS. So in total, that is about – if my math is correct – $55 million of net incremental quarter-to-quarter.

<Q – Brian Peterson>: Okay. And if I'm looking at – even if I kind of adjust for that and I'm looking at your guidance for the next quarter, it still looks like it's a little bit below seasonal. I guess in line to a little bit below. And is that – is that reflective of some of your sled commentary on demand there and if that's the case, is that really – is June really the strong month for that quarter or is that typically back-end loaded for you?

<A – Thomas Alsborg>: June and July are the months that you typically see the sled play in, so that is a factor certainly. But I would comment as Kevin did that if you do the math on this and you just take approximately the midpoint of our guidance, we're still double-digit growth year-over-year, 11.5% or so and sequentially about 5%. So while there is maybe less of an edge on the growth, I would still consider it to be a very good growth.

<Q – Brian Peterson>: Okay. Thank you.

Operator: Your next question comes from Matt Sheerin with Thomas Weisel Partners.

<Q – Matthew Sheerin>: Yes. Thank you. Hi, everyone. So just looking at that $35 million in revenue that goes – that's going from gross to a fee basis, Thomas is that going to be a boost to gross margin?

<A – Thomas Alsborg>: From a margin percentage perspective, yes, that would impact gross margin. Similar kind of concept to the way the net presentation for the service and warranty revenue works, but for very different reason. This is a contractual change.

<Q – Matthew Sheerin>: Got it. Yeah. But that would be – and is there – and it sounds like you've been making a pretty good push on the services side, focusing on more profitable growth. So would you expect that gross margin – I know you don't give specific gross margin guidance, but is there anything in the seasonal mix in your August quarter that would lead gross margin to deteriorate much from current levels on an apples-to-apples basis?

<A – Thomas Alsborg>: We're always going to have opportunities for puts and takes, so I'm going to – the short answer to your question is no, not really. But I would also tell you that, again, it's not a normal for us to have a swing of 10 or 20 basis points just based on the mix of business as the quarter can progress. So no, there's nothing that I would say is expected that would be anything different from the usual puts and takes that you would see in any quarter-to-quarter scenario.

<Q – Matthew Sheerin>: Okay. Okay. And in terms of just looking toward the end of the year, Kevin, you talked about you still feel pretty good about IT spending although maybe on the margin just a little bit of a deceleration of growth. But have you seen anything else or talking to your customers or retailer customers, do they still talk about pretty good pipeline out there?

<A – Kevin Murray>: Yeah, the pipeline opportunities continue to be healthy. There still continues to be, I guess other catalysts that we believe are going to continue to drive growth. The release of Office 2010 that just happened and with Windows 7 now being much more mature, and much more confidence in its deployment, I think both of those factors are also going to help. For our business, we have our seasonally strong period ahead of us for Jack of All Games and that's going to happen during the holiday season. We're looking forward to being able to be a major participant in that part of the business as well. So overall I would tell you the prospects are pretty optimistic, Matt.

<Q – Matthew Sheerin>: Okay. And are you seeing cross-selling opportunities with that Jack of All Games business?

<A – Kevin Murai>: Yeah. In fact, that was one of the core synergies that we identified as making this a very good business for us to get into, in particular with the retail accounts that we have in our existing New Age Electronics business. So, we're already starting to see a lot of those synergies come to reality and we do expect that in the coming quarters, we're going to see that to be significantly more than it is today.

<Q – Matthew Sheerin>: Okay. And just lastly, on product shortages that you talked about in TVs and networking, are you anticipating those issues to ease this quarter? Are you seeing that? Are you seeing more product availability or is that still an issue?

<A – Kevin Murai>: Well, again, just to frame it up as well, as I said, for the items that I identified and of course another one being the SLED business, product shortages as well and pent-up demand releasing, none of them on their own I think are significant issues. That being said, though, we don't have full visibility into every single category where we've seen shortages. I do expect that the printer consumables shortages that we've seen are going to probably continue through this quarter. TVs, we do expect will start to ease up but probably coming more into the holiday season. And from a networking side, again, we do expect that to start to ease up soon, but I don't know if that's going to be this quarter or the following quarter.

<Q – Matthew Sheerin>: Okay. Great. Thanks a lot.

<A – Kevin Murray>: Thanks, Matt.

Operator: Your next question comes from Ananda Baruah with Brean Murray.

<Q – Ananda Baruah>: Hey, guys, thanks for taking the question. Kevin, I guess more of a quick clarification. Am I crazy? I thought I heard a comment that you actually saw or are expecting an acceleration or improvement in business trends?

<A – Kevin Murai>: Sorry, Ananda, I didn't – an acceleration in what?

<Q – Ananda Baruah>: I thought I heard in the prepared remarks that there was a comment around you guys seeing some kind of improvement in business trends. I mean, acceleration is probably my word but at least sort of the allusion feel like that there was improvement somewhere in business trends, did I hear that correctly?

<A – Kevin Murai>: Well, first of all, Ananda, you're not crazy. But no, we didn't say that. What we said was that we're – we continue to see opportunities that's going to continue to fuel the recovery out of the recession.

<Q – Ananda Baruah>: Got it. Okay. Okay. Thanks for the clarification there. And then I guess, Kevin, sounds like when you guys went over the business segments, sounds like pretty much everything was strong across the board and so just wondering sort of in those areas that you might consider more mainstream or kind of mature type of distribution, do you think your – the strong performance was the result of a market share gain or just the market maybe being a little bit better than expected for everybody?

<A – Kevin Murai>: Well, it was really a combination of both. The underlying market continued to I guess even accelerate through Q2, continued to even accelerate its year-on-year performance. And again, we've had a history of growing faster than market. That continued through our second quarter as well. So it's really both. But the underlying market through Q2 was very strong.

<Q – Ananda Baruah>: Got it. Okay. That's helpful. And I guess just on the margins, if my quick math is correct, looks like your core distribution margins improved sequentially and looks like GBS was maybe a little bit soft but still pretty strong. Is there any – and it also looks like, based on your guidance, it looks like the margins are more or less sustainable, the sort of similar levels that you guys are forecasting. Is this – I just want to know what the puts and takes are, I guess maybe the change – does the change in the accounting recognition have anything to do with that? It sounds like it could. But that being said, is this sort of the new level of margin that we should think about the business being at than sort of – also and saying there's numerous new kind of seasonal puts and takes in the business as we move forward?

<A – Kevin Murai>: I guess let me try to answer that, Ananda. You can almost break it down into two or three different categories. So for the underlying core distribution business, as this market continues to mature, I think that we've done a good job in managing the way that we actually extract getting paid for the value that we provide. And so from a gross margin perspective on core, it's very stable environment now. And I do expect that to continue.

The focus that we have on our growth initiatives pretty much across the board are all focused against higher growth areas, but in particular areas or markets that offer higher gross margin and also higher ROIC. So, that's a comment specific to some of the focus areas in different product categories or markets from distribution, whether it be the enterprise server and storage space, whether it be the unified communications area and our growth in consumers electronics too. And then the third component of course is our focus on our GBS business.

So, we've been performing better than market over the past number of years and in particular over the past two quarters as well. You can expect that we're going to continue to make investments in that business and as that becomes a larger part of our overall business, obviously it's going to have a more significant accretive impact to our gross margins as well. So if you take a look at the trend lines over time, it's certainly our focus to continue to move that gross margin line up and to the right.

<Q – Ananda Baruah>: Okay, got it. And I guess just – well, not lastly on margins looking at it another way, your OpEx as a percentage of revenue was also lower than I had anticipated this quarter and just interesting getting your comments on where it was relative to your expectations because obviously that's another important factor on the operating margin. And so, is there anything going on with SG&A dollars that would, sort of, you know, be sustainable. I guess are you doing anything to actually run the business leaner or are you seeing leverage at the OpEx line that's showing up maybe earlier than expected, that's sustainable or anything like that, that will have like a longer tail I guess, it's in the operating margins.

<A – Thomas Alsborg>: Ananda, this is Thomas. I'll take a shot at answering that. First of all, I'd point out that we are seeing leverage in our operating expense and that is probably the biggest driver of the percentage improvement that you're referring to. We actually – as we commented last quarter, we actually did indeed have some additional costs associated with the ramping up of Jack of All Games and that is not expected to continue on a go-forward basis.

So some of the scaling that we would have been – that we incurred in Q2 is actually a little bit muted by some of those additional incremental costs. We commented last quarter that we expected to experience between a 0.5 million and $1 million. We were pretty much on track with that and as we look into Q3, we don't expect to have the same kind of transitional costs associated with Jack.

<Q – Ananda Baruah>: Got it. Let me just ask one more. And maybe if you guys could, just kind of rank order maybe just the – I don't know if it's like two or four, most meaningful things that are kind of driving this next step-up in the operating margin, and maybe sort of, how sustainable those things are. The reason I'm asking the question that way is because, you know, it's been clear that you guys have been communicating that this is an ongoing margin expansion story but the things that I think that I've thought of anyway that have long-term or are driving long-term expansion opportunity actually seem like they were just – they were actually softer this quarter than I would have thought.

So it was actually – it seems like it might be the core business that actually caused the majority or at least a bigger part of this quarter's margin expansion and maybe next quarter's margin expansion as well as margin sustainability.

And so I guess the question is, is that correct and does that mean that you might see a little bit more margin expansion faster than expected or that you might get actually more meaningful margin expansion faster than expected, once the growth areas really begin to kick in as a meaningful percentage of revenue.

<A – Kevin Murai>: No, it's rather than rank ordering them all, I'll talk about three areas, Ananda and I think you hit the nail on the head on one of them, which is, we like to spend a lot of time talking about our strategy, talking about the services component of the business. But part of the reality is that our core IT distribution business continues to have great legs and we continue to make improvements there, and you're right, I mean, that is one of the key levers in our ability to improve our overall margins going forward. It's just becoming much more efficient, adding more value and extracting more gross margin for the existing core business that we do. So that would be one of them.

The second one of course is services. Primarily driven by services out of our GBS unit and as that business continues to grow not only growing as a component of our overall business, but growing into areas that even offer higher gross margin than what we're getting in the existing GBS business too, as we move more into proprietary platforms and actually having more of an end-to-end or soup to nuts solution for our clients.

And then the third piece of course are the growth initiatives that we have. Now, there's too many to go through, but there are some that we do talk to more than others, that tend to be a little bit larger in opportunity such as the enterprise space and other opportunities in managed services. So that really would be – those would really be the three key levers in how we're going to drive our gross margin up over time.

<Q – Ananda Baruah>: Okay. Guys, thanks a lot.

<A – Thomas Alsborg>: Thanks Ananda.

Operator: Your next question comes from Richard Gardner with Citigroup.

<Q – Richard Gardner>: Great. Thank you. Thomas, I was wondering if you'd be willing to give us the Jack contribution to the top line in the quarter?

<A – Thomas Alsborg>: The Jack of All Games revenue was in the range of 40 to $50 million, pretty much on track our expectations and keeping in mind again for our listeners that the Jack of All Games revenue is highly back-end loaded into the last three months of the year because of the nature of that business.

<Q – Richard Gardner>: Okay, great. And I wanted to also touch on the supply constraints, if I could, Kevin. It sounds like it's one step forward and then one step back in terms of product supply, but I think you had referred to printer and hardware as being an area of constraint last quarter. Is that an area where you're actually seeing improvement in supply?

<A – Kevin Murai>: Yeah, actually printer hardware supply did improve and when I talked to the printer consumables areas one of the areas of constraints, again, the statement shouldn't be taken as across the board we have shortages in consumables. There are just narrow lines I guess within consumables where we still experience shortages.

<Q – Richard Gardner>: Can you talk about whether it's more inkjet or laser or color versus black and white?

<A – Kevin Murai>: It is more on the laser side.

<Q – Richard Gardner>: Okay. And the other areas that you referred to, it may be a difficult question to answer, but I'd just love to get your view on whether the supply constraints reflect stronger than expected demand, stronger than your or the OEM's expectations or whether it's more a lack of supply of key components that's driving the shortages out there?

<A – Kevin Murai>: Yeah, well, each category is going to have a different story behind it. I would tell you that in some cases likely the networking category it was more around much higher than anticipated growth in that market. The consumables area is more historic. I mean, we've been facing shortages in printer consumables for some time now and that just has continued a little bit longer than most had anticipated.

<Q – Richard Gardner>: And how about the TV area?

<A – Kevin Murai>: The TV area is really a combination of both, and also there is a technology transition happening right now, so just overall demand and how that demand is balanced between the LED TVs and LCD TVs, so it's really a combination of the two.

<Q – Richard Gardner>: Okay. And then the final question from me is that if there's one area where we've actually heard I think pretty conclusive evidence that there was a slowing and the April, May timeframe, it was in retail. Best Buy talked about a little bit weaker business in a number of different areas and we've heard it from a number of the OEMs like Dell, we saw order cuts for notebooks from Taiwan during those two months.

I'm just wondering if – and I didn't hear you specifically mention that for the products that you distribute. Can you talk about why you think there might be a difference in what you're seeing versus what's going on in the marketplace or what we're hearing from other members of the supply chain?

<A – Kevin Murai>: Yes. Our reach into retail is rather broad, so there were some areas in retail that I would say, yes, we saw some softness in. At the same time though, there were many other parts of our retail business where we saw exceptional growth. And our overall retail business though, was actually a strong point in our second quarter and growth that we had at a New Age Electronics as well as with the combination of Jack of All Games was actually a strong growth category or business unit for us.

<Q – Richard Gardner>: Okay. Great. Thank you very much.

<A – Kevin Murai>: Thanks, Richard.

Operator: [Operator Instructions]. Your next question comes from Shaw Wu with Kaufman Brothers.

<Q – Shaw Wu>: Okay. Thanks. I have two questions. First question is – I guess a two-part question – on inventories, how do you feel about inventory and I guess related to that, is this I guess softer, slightly decelerating growth environment perhaps tied to maybe trying to manage inventories where you maybe a little too strong in the first half?

And then the second question, just excuse me, pardon me, if I missed it, but any comments on enterprise PCs, you had commented in the past that that business was starting to get better so just some color on that. Those are my two questions. Thanks.

<A – Dennis Polk>: Hi, Shaw, this is Dennis. I'll take the inventory question and then turn it over to Kevin for the second one. On the inventory as Thomas noted, our inventory days were a little higher this quarter but mostly due to timing of some deals and the process of working through the acquired Jack inventory. In addition, our quarter actually ended on a holiday and that caused some timing issues as well.

Overall, we're always concerned with the quality of our inventory and when we get a solid return when we sell the product through and in both these cases we are in a positive position right now.

<A – Kevin Murai>: So, for the enterprise side, and Shaw, I just want to make sure I understand your question because I thought you said enterprise PCs. Obviously, our focus is on enterprises and server and storage but also going back and looking at the overall market because my guess is your question is on the market not just what we're seeing too, enterprise was actually one area last year that we did see affected by the recession through much of 2009, but we started seeing the enterprise market coming back towards the end of the year.

We saw good strength in the market starting in this year. We continue to see that as well. The point I want to make though is that for our own enterprise business we're growing at much faster rates than the overall enterprise market because of the focus that we have and also because we're a relatively small player compared to some of the more legacy enterprise players. But it is a market that we believe is one of the factors of growth in 2010. Both in the first half as well as going forward.

<Q – Shaw Wu>: Okay. And if I may, if I could ask the first question again, the question I meant to ask is you talked about how we had these pent-up demand that we had a period of under spend, right, and then we had some pent-up demand and we had some very strong growth, I guess in the first half and now we're talking about things possibly slowing down and my question was, is it perhaps, a question I get a lot is about in terms of channel restocking and that's what I'm trying to get at. Has it been that or – what's going on? Is it real demand really slowing down or is it – maybe we overshot a little too much?

<A – Kevin Murai>: Okay. So well, first of all, I want to address kind of the theme of the question, which is, it's a positive market out there, okay. And I wouldn't – I would not characterize it as the market is slowing down. We benefited from pent-up demand on – in particular on PCs over the past say two quarters or so. But we continue to see strong demand across the board in IT.

One thing that I had said before including today is that when you take a look at year-on-year growth that we've experienced over the past six months, that go well into the teens, you don't expect you're going to see that forever. Because you have that whole pent-up demand being released opportunity that eventually will start to tail off. But the underlying demand is not only stable I think it's very, very strong, and we expect to see that continue to happen.

Now, relating back to inventory, I don't think that inventories are not high because perhaps there was some unseen market softness. From our own perspective, we make decisions on inventory, there's also timing issues on when inventory comes in, when we actually use that inventory to fulfill orders that we have.

So timing is a big factor in that and keep in mind that the inventory that we report is one day. It's a point in time number. So, of course we do buy our inventories not only for anticipated demand but in a lot of cases we buy inventories specific to large deals that we have. So that is not a concern. The quality of inventory is very, very high and we do expect that by the time we talk in 30 days from now we've already flowed through the inventory that we have in our warehouse anyway.

<Q – Shaw Wu>: Okay. Thanks for the clarification and color.

<A>: Thanks, Shaw.

Operator: Your next question is from Matt Sheerin with Thomas Weisel Partners.

<Q – Matthew Sheerin>: Yeah, hi. Just a quick follow-up on your comments regarding the state and local government. It sounded, Kevin, like it was a combination of maybe on the margin a little bit less than seasonal expectations, but also tying that into the product shortages that you saw in the networking area was also a factor that played into the state and local sluggishness, if you will. Is that correct?

<A – Kevin Murai>: I wouldn't necessarily tie the two together.

<Q – Matthew Sheerin>: Okay.

<A – Kevin Murai>: I mean, talking about state and local in particular, probably shouldn't be a big surprise that state and local is a little bit soft because of budget shortfalls that most states are experiencing right now. Federal government spending, by the way, has been – has actually been a strong point. But state and local had been softer than we normally would have expected but not necessarily driven by shortages of product in any given category.

<Q – Matthew Sheerin>: Gotcha. Could you give us your approximate exposure to government, both on state and local level and federal? Is it more than 5% or less than that?

<A – Thomas Alsborg>: Our total government is in the teens. On the state and local level that number is below 5%, a little bit below 5%.

<Q – Matthew Sheerin>: Okay. So you have a little bit more federal exposure then?

<A – Thomas Alsborg>: Yes.

<Q – Matthew Sheerin>: Okay. And then do you have any visibility into the September timeframe which is obviously the big uptick there? That's not in your August quarter but I guess there's probably some build going into that. Do you have any expectations for that business this season?

<**A – Kevin Murai**>**:** Again, it's farther out there than we typically have visibility into. Although, I would tell you that what we've been seeing so far is that federal has been holding up and at least our expectation right now is that we'll see a normal federal spending season this year.

<**Q – Matthew Sheerin**>**:** Okay. Thanks for the insight.

Operator: Your final question comes from Lou Miscioscia with Collins Stewart.

<**Q – Louis Miscioscia**>**:** Okay. Thank you. Mine is a follow-up to one of the answers that you had. In that you had said you were broadening retailing that in some areas you saw softness, in some areas you saw exceptional growth. Can you give us a little more color on what you saw softness and what you saw exceptional growth?

<**A – Kevin Murai**>**:** Yeah. Now we're starting to get into some of the real detail on our business which we're not always comfortable sharing. But I think I would be comfortable telling you that TV of course is a big part of our retail business, so that the shortages in retail certainly – in TVs certainly did affect our sales in the retail part of the business.

But the other strength that we saw were in many other parts including our Jack of All Games business and how we're able to drive synergies there and in the IT related or the consumer IT related products such as notebooks and netbooks. That was also a strong point in the retail segment of our business.

<**Q – Louis Miscioscia**>**:** Okay. So then the trends you saw there were different than maybe Best Buy and I guess some of the comments that Dell had, you were actually seeing strength where some of them were already started to see some weaknesses?

<**A – Kevin Murai**>**:** Yes.

<**Q – Louis Miscioscia**>**:** Okay. Well, then maybe this next just a last quick follow-up. If the consumer – if – have you – in what you might have seen from maybe Best Buy and others, it seems like the consumer might be pausing and any read or kind of comment you might give us as to why that might be happening?

<**A – Kevin Murai**>**:** Tough for me to call and I should also clarify that when you look at what we call retail and the retail customers we address are more in the regional retailer or Tier 2 retail players. Our New Age business as well, that all comes under retail, also includes electronic retailers too. But so far for us, we've seen at least continued stable and strong spending in our retail business and so even though it was somewhat affected by some product shortages, overall we feel that we have actually a pretty strong market still.

<**Q – Louis Miscioscia**>**:** Okay, great. Appreciate you answering the questions.

<**A – Kevin Murai**>**:** Thank you, Louis.

Laura Crowley, Director of Investor Relations and Public Relations

Well, okay, thank you. This concludes our second quarter earnings conference call. Thank you all for joining us today. We will have a replay of this call available for two weeks beginning today at approximately 5 p.m. Pacific time through July 8, 2010. As always, should you have any follow-up questions, both Thomas and I are available to take your calls.

Operator: This concludes today's conference call. You may now disconnect.