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POOL CORP
Form 10-Q
October 28, 2016

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 0-26640

POOL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 36-3943363
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

109 Northpark Boulevard,
Covington, Louisiana 70433-5001
(Address of principal executive offices) (Zip Code)

985-892-5521
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 24, 2016, there were 41,339,248 shares of common stock outstanding.

POOL CORPORATION
Form 10-Q
For the Quarter Ended September 30, 2016

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

POOL CORPORATION

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$691,429	\$645,779	\$2,125,568	\$1,948,064
Cost of sales	491,878	461,491	1,512,258	1,390,715
Gross profit	199,551	184,288	613,310	557,349
Selling and administrative expenses	125,385	118,776	367,194	347,106
Operating income	74,166	65,512	246,116	210,243
Interest and other non-operating expenses, net	2,989	2,473	9,954	6,368
Income before income taxes and equity earnings	71,177	63,039	236,162	203,875
Provision for income taxes	26,807	23,704	90,244	78,489
Equity earnings in unconsolidated investments, net	51	68	113	259
Net income	44,421	39,403	146,031	125,645
Net loss attributable to noncontrolling interest	113	44	309	144
Net income attributable to Pool Corporation	\$44,534	\$39,447	\$146,340	\$125,789
Earnings per share:				
Basic	\$1.06	\$0.92	\$3.48	\$2.91
Diluted	\$1.03	\$0.90	\$3.39	\$2.83
Weighted average shares outstanding:				
Basic	42,020	42,826	42,092	43,266
Diluted	43,119	43,939	43,201	44,407
Cash dividends declared per common share	\$0.31	\$0.26	\$0.88	\$0.74

The accompanying Notes are an integral part of the Consolidated Financial Statements.

POOL CORPORATION

Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net income	\$44,421	\$39,403	\$146,031	\$125,645
Other comprehensive income (loss):				
Foreign currency translation adjustments	96	(2,792)	1,367	(8,482)
Change in unrealized gains and losses on interest rate swaps, net of change in taxes of \$(400), \$525, \$882 and \$1,002	625	(822)	(1,379)	(1,568)
Total other comprehensive income (loss)	721	(3,614)	(12)	(10,050)
Comprehensive income	45,142	35,789	146,019	115,595
Comprehensive loss attributable to noncontrolling interest	45	310	198	656
Comprehensive income attributable to Pool Corporation	\$45,187	\$36,099	\$146,217	\$116,251

The accompanying Notes are an integral part of the Consolidated Financial Statements.

POOL CORPORATION

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2016 (Unaudited)	September 30, 2015 (Unaudited)	December 31, 2015 ⁽¹⁾
Assets			
Current assets:			
Cash and cash equivalents	\$ 30,292	\$ 29,504	\$ 13,237
Receivables, net	81,072	70,399	54,173
Receivables pledged under receivables facility	152,333	149,375	102,583
Product inventories, net	455,156	412,587	474,275
Prepaid expenses and other current assets	12,084	11,062	11,946
Deferred income taxes	5,288	3,256	5,530
Total current assets	736,225	676,183	661,744
Property and equipment, net	84,643	66,296	69,854
Goodwill	185,486	172,150	172,761
Other intangible assets, net	13,645	11,393	11,845
Equity interest investments	1,152	1,196	1,231
Other assets	16,370	13,682	16,926
Total assets	\$ 1,037,521	\$ 940,900	\$ 934,361
Liabilities, redeemable noncontrolling interest and stockholders' equity			
Current liabilities:			
Accounts payable	\$ 199,922	\$ 170,582	\$ 246,554
Accrued expenses and other current liabilities	126,654	77,298	56,591
Short-term borrowings and current portion of long-term debt and other long-term liabilities	1,298	1,799	1,700
Total current liabilities	327,874	249,679	304,845
Deferred income taxes	28,359	22,755	29,808
Long-term debt, net	388,891	391,571	326,345
Other long-term liabilities	17,945	13,216	14,955
Total liabilities	763,069	677,221	675,953
Redeemable noncontrolling interest	2,467	2,457	2,665
Stockholders' equity:			
Common stock, \$0.001 par value; 100,000,000 shares authorized; 41,711,888, 42,620,194 and 42,711,016 shares issued and outstanding at September 30, 2016, September 30, 2015 and December 31, 2015, respectively	42	43	43
Additional paid-in capital	399,071	361,553	374,138
Retained deficit	(113,276)	(87,174)	(104,709)
Accumulated other comprehensive loss	(13,852)	(13,200)	(13,729)
Total stockholders' equity	271,985	261,222	255,743
Total liabilities, redeemable noncontrolling interest and stockholders' equity	\$ 1,037,521	\$ 940,900	\$ 934,361

(1) Derived from audited financial statements.

The accompanying Notes are an integral part of the Consolidated Financial Statements.

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POOL CORPORATION

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2016	2015
Operating activities		
Net income	\$ 146,031	\$ 125,645
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	15,020	11,920
Amortization	1,288	771
Share-based compensation	7,373	7,112
Excess tax benefits from share-based compensation	(6,582)	(4,916)
Equity earnings in unconsolidated investments, net	(113)	(259)
Other	3,799	2,314
Changes in operating assets and liabilities, net of effects of acquisitions:		
Receivables	(71,936)	(78,662)
Product inventories	23,624	52,463
Prepaid expenses and other assets	(1,094)	296
Accounts payable	(49,479)	(66,035)
Accrued expenses and other current liabilities	75,239	27,334
Net cash provided by operating activities	143,170	77,983
Investing activities		
Acquisition of businesses, net of cash acquired	(19,314)	(602)
Purchase of property and equipment, net of sale proceeds	(30,388)	(21,299)
Payments to fund credit agreement	(3,852)	(6,300)
Collections from credit agreement	3,300	4,557
Other investments, net	21	75
Net cash used in investing activities	(50,233)	(23,569)
Financing activities		
Proceeds from revolving line of credit	873,854	721,835
Payments on revolving line of credit	(866,801)	(690,677)
Proceeds from asset-backed financing	145,000	128,400
Payments on asset-backed financing	(90,000)	(85,800)
Proceeds from short-term borrowings, long-term debt and other long-term liabilities	15,705	4,948
Payments on short-term borrowings, long-term debt and other long-term liabilities	(16,107)	(4,678)
Excess tax benefits from share-based compensation	6,582	4,916
Proceeds from stock issued under share-based compensation plans	10,978	10,906
Payments of cash dividends	(37,007)	(32,008)
Purchases of treasury stock	(117,901)	(90,306)
Net cash used in financing activities	(75,697)	(32,464)
Effect of exchange rate changes on cash and cash equivalents	(185)	(7,276)
Change in cash and cash equivalents	17,055	14,674
Cash and cash equivalents at beginning of period	13,237	14,830
Cash and cash equivalents at end of period	\$ 30,292	\$ 29,504

The accompanying Notes are an integral part of the Consolidated Financial Statements.

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POOL CORPORATION

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 – Summary of Significant Accounting Policies

Pool Corporation (the Company, which may be referred to as we, us or our) prepared the unaudited interim Consolidated Financial Statements following U.S. generally accepted accounting principles (GAAP) and the requirements of the Securities and Exchange Commission (SEC) for interim financial information. As permitted under those rules, we have condensed or omitted certain footnotes and other financial information required for complete financial statements.

We own a 60% interest in Pool Systems Pty. Ltd. (PSL), an Australian company. This constitutes a controlling interest in the acquired company, which requires us to consolidate PSL's financial position and results of operations from the date of acquisition.

The Consolidated Financial Statements include all normal and recurring adjustments that are necessary for a fair presentation of our financial position and operating results. All significant intercompany accounts and intercompany transactions have been eliminated.

A description of our significant accounting policies is included in our 2015 Annual Report on Form 10-K. You should read the interim Consolidated Financial Statements in conjunction with the Consolidated Financial Statements and accompanying notes in our Annual Report. The results for our three and nine month periods ended September 30, 2016 are not necessarily indicative of the expected results for our fiscal year ending December 31, 2016.

Variable Interest Entity

In February 2015, we entered into a five-year credit agreement with a swimming pool retailer. Under this agreement and the related revolving note, we are the primary lender of operating funds for this entity. The total lending commitment under the credit agreement is \$8.5 million, of which \$7.3 million is owed as of September 30, 2016. Amounts outstanding under the credit agreement are recorded within Other assets on our Consolidated Balance Sheets and are collateralized by essentially all of the assets of the business. We have a variable interest in this entity; however, we have no decision-making authority over its activities through voting or other rights. Additionally, we have no obligation to absorb any of its losses, nor do we have the right to receive any residual returns, should either occur. We are not considered the primary beneficiary of this variable interest entity, and therefore we are not required to consolidate this entity's financial statements.

Retained Deficit

We account for the retirement of treasury shares as a reduction of retained earnings (deficit). As of September 30, 2016, the Retained deficit on our Consolidated Balance Sheets reflects cumulative net income, the cumulative impact of adjustments for changes in accounting pronouncements, treasury share retirements since the inception of our share repurchase programs of \$1,032.8 million and cumulative dividends of \$355.0 million.

New Accounting Pronouncements

Upon adoption of Accounting Standards Update (ASU) 2015-03, Interest - Imputation of Interest (Subtopic 8365-30) - Simplifying the Presentation of Debt Issuance Costs, we now include financing costs, net of accumulated amortization as a component of long-term debt. For comparability across all periods presented on our Consolidated Balance Sheets, we reclassified certain amounts from Other assets, net in 2015 to Long-term debt, net to conform to our 2016

presentation.

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Note 2 – Earnings Per Share

We calculate basic earnings per share (EPS) by dividing Net income attributable to Pool Corporation by the weighted average number of common shares outstanding. We include outstanding unvested restricted stock awards of our common stock in the basic weighted average share calculation. Diluted EPS includes the dilutive effects of other share-based awards. Stock options with exercise prices that are higher than the average market prices of our common stock for the periods presented are excluded from the diluted EPS calculation because the effect is anti-dilutive.

The table below presents the computation of EPS, including the reconciliation of basic and diluted weighted average shares outstanding (in thousands, except EPS):

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net income	\$44,421	\$39,403	\$146,031	\$125,645
Net loss attributable to noncontrolling interest	113	44	309	144
Net income attributable to Pool Corporation	\$44,534	\$39,447	\$146,340	\$125,789
Weighted average shares outstanding:				
Basic	42,020	42,826	42,092	43,266
Effect of dilutive securities:				
Stock options and employee stock purchase plan	1,099	1,113	1,109	1,141
Diluted	43,119	43,939	43,201	44,407
Earnings per share:				
Basic	\$1.06	\$0.92	\$3.48	\$2.91
Diluted	\$1.03	\$0.90	\$3.39	\$2.83
Anti-dilutive stock options excluded from diluted earnings per share computations	1	—	1	176

Note 3 – Acquisitions

In April 2016, we acquired the distribution assets of Metro Irrigation Supply Company Ltd., an irrigation and landscape supply company with eight locations in Texas.

In November 2015, we acquired the distribution assets of The Melton Corporation, a masonry materials and supplies distributor with one sales center location in California and one sales center location in Arizona.

In October 2015, we acquired the distribution assets of Seaboard Industries, Inc., a swimming pool supply wholesale distributor with one sales center location in Connecticut and two sales center locations in New Jersey.

In April 2015, we acquired certain distribution assets from Poolwerx Development LLC and opened a satellite sales center location serving South Mesa, Arizona.

We have completed our acquisition accounting for these acquisitions, subject to adjustments for standard holdback provisions per the terms of the purchase agreements, which are not material. These acquisitions did not have a material impact on our financial position or results of operations, either individually or in the aggregate.

In December 2014, we acquired certain distribution assets of St. Louis Hardscape Material & Supply, LLC, a hardscape and landscaping materials supplier with one location in St. Louis, Missouri. Because this acquisition was completed on December 31, 2014, we have included the results of this acquired company beginning January 1, 2015.

We completed our acquisition accounting for this acquisition. This acquisition did not have a material impact on our financial position or results of operations.

Note 4 – Fair Value Measurements and Interest Rate Swaps

Our assets and liabilities that are measured at fair value on a recurring basis include the unrealized gains or losses on our interest rate swap contracts and contingent consideration related to recent acquisitions. The three levels of the fair value hierarchy under the accounting guidance are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 Inputs to the valuation methodology include:

• quoted prices for similar assets or liabilities in active markets;

• quoted prices for identical or similar assets or liabilities in inactive markets;

• inputs other than quoted prices that are observable for the asset or liability; or

• inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The table below presents the estimated fair values of our interest rate swap contracts, our forward-starting interest rate swap contracts and our contingent consideration liabilities (in thousands):

	Fair Value at September 30,	
	2016	2015
Level 2		
Unrealized gains on interest rate swaps	\$32	\$—
Unrealized losses on interest rate swaps	\$6,174	\$4,777
Level 3		
Contingent consideration liabilities	\$1,626	\$—

Interest Rate Swaps

We utilize interest rate swap contracts and forward-starting interest rate swap contracts to reduce our exposure to fluctuations in variable interest rates for future interest payments on our unsecured syndicated senior credit facility (the Credit Facility).

For determining the fair value of our interest rate swap contracts, we use significant other observable market data or assumptions (Level 2 inputs) that we believe market participants would use in pricing similar assets or liabilities, including assumptions about counterparty risk. Our fair value estimates reflect an income approach based on the terms of the interest rate swap contracts and inputs corroborated by observable market data including interest rate curves. We include unrealized gains in Prepaid expenses and other current assets and unrealized losses in Accrued expenses and other current liabilities on the Consolidated Balance Sheets.

We recognize any differences between the variable interest rate payments and the fixed interest rate settlements from our swap counterpart