

POOL CORP
Form 10-Q
October 31, 2017

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, 2017

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 26, 2017, there were 40,166,800 shares of common stock outstanding.

POOL CORPORATION
Form 10-Q
For the Quarter Ended September 30, 2017

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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,		September 30,	
	2017	2016	2017	2016
Net sales	\$743,401	\$691,429	\$2,278,005	\$2,125,568
Cost of sales	526,795	491,878	1,618,114	1,512,258
Gross profit	216,606	199,551	659,891	613,310
Selling and administrative expenses	134,678	125,385	392,779	367,194
Operating income	81,928	74,166	267,112	246,116
Interest and other non-operating expenses, net	4,009	2,989	11,608	9,954
Income before income taxes and equity earnings	77,919	71,177	255,504	236,162
Provision for income taxes	29,179	26,807	89,951	90,244
Equity earnings in unconsolidated investments, net	43	51	121	113
Net income	48,783	44,421	165,674	146,031
Net loss attributable to noncontrolling interest	—	113	294	309
Net income attributable to Pool Corporation	\$48,783	\$44,534	\$165,968	\$146,340
Earnings per share:				
Basic	\$1.20	\$1.06	\$4.04	\$3.48
Diluted	\$1.16	\$1.03	\$3.89	\$3.39
Weighted average shares outstanding:				
Basic	40,659	42,020	41,065	42,092
Diluted	42,207	43,119	42,691	43,201
Cash dividends declared per common share	\$0.37	\$0.31	\$1.05	\$0.88

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, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Net income	\$48,783	\$44,421	\$165,674	\$146,031
Other comprehensive income (loss):				
Foreign currency translation adjustments	1,842	96	6,432	1,367
Change in unrealized gains and losses on interest rate swaps, net of change in taxes of \$(181), \$(400), \$(432) and \$882	283	625	675	(1,379)
Total other comprehensive income (loss)	2,125	721	7,107	(12)
Comprehensive income	50,908	45,142	172,781	146,019
Comprehensive loss attributable to noncontrolling interest	—	45	74	198
Comprehensive income attributable to Pool Corporation	\$50,908	\$45,187	\$172,855	\$146,217

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

POOL CORPORATION

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2017 (Unaudited)	September 30, 2016 (Unaudited)	December 31, 2016 ⁽¹⁾
Assets			
Current assets:			
Cash and cash equivalents	\$ 36,398	\$ 30,292	\$ 21,956
Receivables, net	90,142	81,072	61,437
Receivables pledged under receivables facility	172,654	152,333	104,714
Product inventories, net	484,287	455,156	486,116
Prepaid expenses and other current assets	14,832	12,084	15,318
Deferred income taxes	—	5,288	6,016
Total current assets	798,313	736,225	695,557
Property and equipment, net	103,880	84,643	83,290
Goodwill	189,024	185,486	184,795
Other intangible assets, net	13,206	13,645	13,326
Equity interest investments	1,168	1,152	1,172
Other assets	16,333	16,370	15,955
Total assets	\$ 1,121,924	\$ 1,037,521	\$ 994,095
Liabilities, redeemable noncontrolling interest and stockholders' equity			
Current liabilities:			
Accounts payable	\$ 209,062	\$ 199,922	\$ 230,728
Accrued expenses and other current liabilities	87,887	126,654	64,387
Short-term borrowings and current portion of long-term debt and other long-term liabilities	8,609	1,298	1,105
Total current liabilities	305,558	327,874	296,220
Deferred income taxes	27,244	28,359	34,475
Long-term debt, net	555,964	388,891	436,937
Other long-term liabilities	22,614	17,945	18,966
Total liabilities	911,380	763,069	786,598
Redeemable noncontrolling interest	—	2,467	2,287
Stockholders' equity:			
Common stock, \$0.001 par value; 100,000,000 shares authorized; 40,122,935, 41,711,888 and 41,089,720 shares issued and outstanding at September 30, 2017, September 30, 2016 and December 31, 2016, respectively	40	42	41
Additional paid-in capital	420,946	399,071	403,162
Retained deficit	(202,693)	(113,276)	(183,915)
Accumulated other comprehensive loss	(7,749)	(13,852)	(14,078)
Total stockholders' equity	210,544	271,985	205,210
Total liabilities, redeemable noncontrolling interest and stockholders' equity	\$ 1,121,924	\$ 1,037,521	\$ 994,095

(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,	
	2017	2016
Operating activities		
Net income	\$ 165,674	\$ 146,031
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	17,947	15,020
Amortization	1,132	1,288
Share-based compensation	9,496	7,373
Excess tax benefits from share-based compensation	—	(6,582)
Equity earnings in unconsolidated investments, net	(121)	(113)
Other	1,074	3,799
Changes in operating assets and liabilities, net of effects of acquisitions:		
Receivables	(90,204)	(71,936)
Product inventories	9,057	23,624
Prepaid expenses and other assets	(1,523)	(1,094)
Accounts payable	(27,328)	(49,479)
Accrued expenses and other current liabilities	26,816	75,239
Net cash provided by operating activities	112,020	143,170
Investing activities		
Acquisition of businesses, net of cash acquired	(6,879)	(19,314)
Purchase of property and equipment, net of sale proceeds	(37,709)	(30,388)
Payments to fund credit agreement	—	(3,852)
Collections from credit agreement	—	3,300
Other investments, net	4	21
Net cash used in investing activities	(44,584)	(50,233)
Financing activities		
Proceeds from revolving line of credit	918,338	873,854
Payments on revolving line of credit	(857,609)	(866,801)
Proceeds from asset-backed financing	156,600	145,000
Payments on asset-backed financing	(97,800)	(90,000)
Proceeds from short-term borrowings, long-term debt and other long-term liabilities	25,001	15,705
Payments on short-term borrowings, long-term debt and other long-term liabilities	(17,497)	(16,107)
Payments of deferred and contingent acquisition consideration	(199)	—
Payments of deferred financing costs	(909)	—
Purchase of redeemable noncontrolling interest	(2,573)	—
Excess tax benefits from share-based compensation	—	6,582
Proceeds from stock issued under share-based compensation plans	8,647	10,978
Payments of cash dividends	(43,165)	(37,007)
Purchases of treasury stock	(141,580)	(117,901)
Net cash used in financing activities	(52,746)	(75,697)
Effect of exchange rate changes on cash and cash equivalents	(248)	(185)
Change in cash and cash equivalents	14,442	17,055

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Cash and cash equivalents at beginning of period	21,956	13,237
Cash and cash equivalents at end of period	\$36,398	\$30,292

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

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.

Through June 29, 2017, we owned a 60% interest in Pool Systems Pty. Ltd. (PSL), an Australian company. Our ownership percentage constituted a controlling interest in the acquired company, which required us to consolidate PSL's financial position and results of operations from the date of acquisition. On June 29, 2017, we purchased the remaining 40% interest in PSL. Thus, we will continue to consolidate PSL, but there will no longer be a separate noncontrolling interest reported on our Consolidated Statements of Income, nor Redeemable noncontrolling interest reported on our Consolidated Balance Sheets. Please see Note 6 - Redeemable Noncontrolling Interest for additional information regarding this transaction.

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 2016 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, 2017 are not necessarily indicative of the expected results for our fiscal year ending December 31, 2017.

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, which is fully funded. As of September 30, 2017, the estimated realizable amount under the credit agreement is recorded within Other assets on our Consolidated Balance Sheets and is 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, 2017, 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 \$1,234.9 million and cumulative dividends of \$410.9 million.

Newly Adopted Accounting Pronouncements

Effective January 1, 2017, we adopted Accounting Standards Update (ASU) 2016-09, Improvements to Employee Share-Based Payment Accounting, on a prospective basis and as such, our prior year presentation has not changed. The provisions of this update simplify many key aspects of the accounting for and cash flow presentation of employee share-based compensation transactions, including accounting for income taxes, forfeitures, and statutory withholding requirements. In accordance with the new guidance, we now record all excess tax benefits or tax deficiencies as a component of our Provision for income taxes on our Consolidated Statements of Income. As a result of the adoption, we recognized \$7.7 million of excess tax benefits in the first nine months of 2017, which reduced our Provision for income taxes and positively impacted our Net income. Historically, these amounts were recorded as Additional paid in capital in stockholders' equity on our Consolidated Balance Sheets. Additionally, we now present excess tax benefits or deficiencies as operating cash flows versus reclassifying the amount out of operating cash flows and presenting it in financing activities on the Condensed Consolidated Statements of Cash Flows.

Additional amendments from this guidance related to forfeitures and minimum statutory withholding tax requirements had no impact to our financial position, results of operations or cash flows. As permitted, we continue to estimate forfeitures to determine the amount of compensation cost to be recognized each period rather than electing to account for forfeitures as they occur, and we continue to present the value of shares withheld for minimum statutory tax withholding requirements on the Condensed Consolidated Statements of Cash Flows as a financing activity. Another impact of the adoption is that the calculation of the effect of dilutive securities now excludes any derived excess tax benefits or deficiencies from assumed future proceeds, resulting in an increase in diluted weighted average shares outstanding of approximately 550,000 shares for the nine month period ended September 30, 2017.

Effective January 1, 2017, we adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which requires we classify all deferred tax assets and liabilities as noncurrent on the balance sheet rather than separately presenting net deferred tax assets or liabilities as current or noncurrent. Additionally, we no longer allocate valuation allowances between current and noncurrent deferred tax assets because those allowances are also now classified as noncurrent. As permitted, we elected to adopt this guidance on a prospective basis and as such, our prior year presentation has not changed. The adoption of ASU 2015-17 did not have a material impact on our financial position, results of operations and related disclosures.

In January 2017, we adopted ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires that we measure inventory at the lower of cost or net realizable value rather than at the lower of cost or market. Net realizable value is the estimated selling price in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. The adoption of ASU 2015-11 did not have a material impact on our financial position, results of operations and related disclosures.

In January 2017, we adopted ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment. The adoption of ASU 2015-16 did not have a material impact on our financial position, results of operations and related disclosures.

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 reflects the dilutive effects of potentially dilutive securities, which include in-the-money outstanding stock options and shares to be purchased under our employee stock purchase plan. Using the treasury stock method, the effect of dilutive securities includes these additional shares of common stock that would have been outstanding based on the assumption that these potentially dilutive securities had been issued. As discussed in Note 1, as a result of the adoption of ASU 2016-09, the calculation of the effect of dilutive securities now excludes any derived excess tax benefits or deficiencies from assumed future proceeds, resulting in an increase in diluted weighted average shares outstanding for the three and nine months ended September 30, 2017.

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, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Net income	\$48,783	\$44,421	\$165,674	\$146,031
Net loss attributable to noncontrolling interest	—	113	294	309
Net income attributable to Pool Corporation	\$48,783	\$44,534	\$165,968	\$146,340
Weighted average shares outstanding:				
Basic	40,659	42,020	41,065	42,092
Effect of dilutive securities:				
Stock options and employee stock purchase plan	1,548	1,099	1,626	1,109
Diluted	42,207	43,119	42,691	43,201
Earnings per share:				
Basic	\$1.20	\$1.06	\$4.04	\$3.48
Diluted	\$1.16	\$1.03	\$3.89	\$3.39
Anti-dilutive stock options excluded from diluted earnings per share computations	108	1	108	1

Note 3 – Acquisitions

On July 4, 2017, we acquired New Star Holdings Pty. Ltd. (doing business as Newline Pool Products), a swimming pool equipment and supplies distributor with one distribution center in Brisbane, Australia.

On April 28, 2017, we acquired the distribution assets of Lincoln Equipment, Inc. (Lincoln Aquatics), a national distributor of equipment and supplies to commercial and institutional swimming pool customers, with two locations in California.

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.

On April 1, 2016, we acquired the distribution assets of Metro Irrigation Supply Company Ltd., an irrigation and landscape supply company with eight locations in Texas.

We have 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,	
	2017	2016
Level 2		
Unrealized gains on interest rate swaps	\$1,201	\$32
Unrealized losses on interest rate swaps	1,791	6,174
Level 3		
Contingent consideration liabilities	\$1,924	\$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 counterparties as an adjustment to interest expense over the life of the swaps. We designated these swaps as cash flow hedges, and to the extent effective we record the changes in the estimated fair value of the swaps to Accumulated other comprehensive loss on our Consolidated Balance Sheets. To the extent our interest rate swaps are determined to be ineffective, we recognize the changes in the estimated fair value of our swaps in earnings.

We currently have three interest rate swap contracts in place, which became effective on October 19, 2016. These swaps were previously forward-starting contracts that were amended in October 2015 to bring the fixed rates per our forward-starting contracts in line with current market rates and extend the hedged period for future interest payments on our Credit Facility. As amended, these swap contracts terminate on November 20, 2019. In the first nine months of 2017, we recognized a benefit of \$1.3 million as a result of our determination of ineffectiveness for the period. These amounts were recorded in Interest and other non-operating expenses, net on our Consolidated Statements of Income.

The following table provides additional details related to each of these amended swap contracts:

Derivative	Amendment Date	Notional Amount (in millions)	Fixed Interest Rate
Interest rate swap 1	October 1, 2015	\$75.0	2.273%
Interest rate swap 2	October 1, 2015	\$25.0	2.111%
Interest rate swap 3	October 1, 2015	\$50.0	2.111%

Upon amendment of the original hedge agreements, we were required to freeze the amounts related to the changes in the fair values of these swaps, which are recorded in Accumulated other comprehensive loss. At September 30, 2017, the remaining balance of the unrealized losses was \$1.9 million and is being amortized over the effective period of the original forward-starting interest rate swap contracts from October 2016 to September 2018. In the first nine months of 2017, we recorded expense of \$1.4 million as amortization of the unrealized loss in Interest and other non-operating expenses, net.

For the three interest rate swap contracts in effect at September 30, 2017, a portion of the change in the estimated fair value between periods relates to future interest expense. Recognition of the change in fair value between periods attributable to accrued interest is reclassified from Accumulated other comprehensive loss on the Consolidated Balance Sheets to Interest and other non-operating expenses, net on the Consolidated Statements of Income. These amounts were not material in the three and nine month periods ended September 30, 2017 and September 30, 2016.

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In July 2016 we entered into an additional forward-starting interest rate swap contract to extend the hedged period for future interest payments on our Credit Facility to its maturity date at that time. This swap contract will convert the variable interest rate to a fixed interest rate on borrowings under the Credit Facility. This contract becomes effective on November 20, 2019 and terminates on November 20, 2020. The following table provides additional details related to this swap contract:

Derivative	Inception Date	Notional Amount (in millions)	Fixed Interest Rate
Forward-starting interest rate swap 1	July 6, 2016	\$150.0	1.1425%

Failure of our swap counterparties would result in the loss of any potential benefit to us under our swap agreements. In this case, we would still be obligated to pay the variable interest payments underlying our debt agreements. Additionally, failure of our swap counterparties would not eliminate our obligation to continue to make payments under our existing swap agreements if we continue to be in a net pay position.

Our interest rate swap and forward-starting interest rate swap contracts are subject to master netting arrangements. According to our accounting policy, we do not offset the fair values of assets with the fair values of liabilities related to these contracts.

Contingent Consideration Liabilities

As of September 30, 2017, our Consolidated Balance Sheets reflected \$0.7 million in Accrued expenses and other current liabilities and \$1.2 million in Other long-term liabilities for contingent consideration related to future payouts for our acquisitions of The Melton Corporation, which we acquired in November 2015, Metro Irrigation Supply Company Ltd. and Newline Pool Products. In determining our original estimates for contingent consideration, which are based on a percentage of gross profit for certain products for The Melton Corporation and a multiple of gross profit for Metro Irrigation Supply Company Ltd., we applied a linear model using our best estimate of gross profit projections for fiscal years 2016 to 2020. The payout for Newline Pool Products is based on a multiple of earnings for the first fiscal year of the acquisition. We based our estimate for the Newline payout on projected operating results for that year. All of our estimates of contingent consideration use Level 3 inputs as defined in the accounting guidance. The maximum total payouts for Metro Irrigation Supply Company Ltd. and Newline Pool Products over the related time periods are \$1.0 million and AU\$0.5 million, respectively.

In the first nine months of 2017, we paid approximately \$0.2 million in contingent consideration to The Melton Corporation based on 2016 results. Since the acquisition dates, we have recorded minimal adjustments to our original estimates based on the calculated 2017 payouts related to the fiscal year ended December 31, 2016. Adjustments to the fair value of contingent consideration are recognized in earnings in the period in which we determine that the fair value changed. As of September 30, 2017, we have determined that the contingent consideration liability was in a range of acceptable estimates for all applicable fiscal periods.

Other

The carrying values of cash, receivables, accounts payable and accrued liabilities approximate fair value due to the short maturity of those instruments (Level 1 inputs). For the note receivable with our variable interest entity, our determination of the estimated fair value reflects a discounted cash flow model using our estimates, including assumptions related to collectibility (Level 3 inputs). The carrying value of this note receivable, including adjustments, approximates fair value. The carrying value of long-term debt approximates fair value. Our determination of the estimated fair value reflects a discounted cash flow model using our estimates, including assumptions related to borrowing rates (Level 3 inputs).

Note 5 – Debt

The table below presents the components of our debt (in thousands):

	September 30,	
	2017	2016
Variable rate debt		
Short-term borrowings	\$—	\$—

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Current portion of long-term debt:		
Australian credit facility	8,609	1,298
Short-term borrowings and current portion of long-term debt and other long-term liabilities	8,609	1,298
Long-term portion:		
Revolving credit facility	415,277	280,068
Receivables securitization facility	142,300	110,000
Less: financing costs, net	1,613	1,177
Long-term debt, net	555,964	388,891
Total debt	\$564,573	\$390,189

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Revolving Credit Facility

On September 29, 2017, we entered into the Amended and Restated Credit Agreement (the Agreement) among us, as US Borrower, SCP Distributors Canada Inc., as Canadian Borrower, SCP Pool B.V., as Dutch Borrower, Wells Fargo Bank, National Association, as Joint Lead Arranger and Administrative Agent, and certain other joint lead arrangers, syndication agents and lenders. The Agreement amends and restates our existing unsecured syndicated senior credit facility (the Credit Facility) principally in the following ways:

- extends the maturity date to September 29, 2022;
- increases the borrowing capacity to \$750.0 million from \$465.0 million; and
- provides other changes to interest rates, fees and negative covenants as outlined below.

The Credit Facility includes sublimits for the issuance of swingline loans and standby letters of credit. Pursuant to an accordion feature, the aggregate maximum principal amount of the commitments under the Credit Facility may be increased at our request and with agreement by the lenders by up to \$75.0 million, to a total of \$825.0 million.

Our obligations under the Credit Facility are guaranteed by certain of our subsidiaries. The Credit Facility also contains affirmative and negative covenants and events of default customary for transactions of this type. If we default under the Credit Facility, the lenders may terminate their commitments and may require us to repay all amounts.

Revolving borrowings under the Credit Facility bear interest, at our option, at either of the following and, in each case, plus an applicable margin:

- a. a base rate, which is the highest of (i) the Wells Fargo Bank, National Association prime rate, (ii) the Federal Funds Rate plus 0.500% and (iii) the London Interbank Offered Rate (LIBOR) Market Index Rate plus 1.000%; or
- b. LIBOR.

Borrowings by the Canadian Borrower bear interest, at the Canadian Borrower's option, at either of the following and, in each case, plus an applicable margin:

- a. a base rate, which is the greatest of (i) the Canadian Reference Bank prime rate and (ii) the annual rate of interest equal to the sum of the Canadian Dealer Offered Rate (CDOR) plus 1.000%; or
- b. CDOR.

Borrowings by the Dutch Borrower bear interest at LIBOR plus an applicable margin.

The interest rate margins on the borrowings and letters of credit are based on our leverage ratio and will range from 1.025% to 1.425% on CDOR, LIBOR and swingline loans, and from 0.025% to 0.425% on Base Rate and Canadian Base Rate loans. Borrowings under the swingline loans are based on the LIBOR Market Index Rate (LMIR) plus any applicable margin. We are also required to pay an annual facility fee ranging from 0.100% to 0.200%, depending on our leverage ratio.

Receivables Securitization Facility

The Receivables Securitization Facility (the Receivables Facility) provides for the sale of certain of our receivables to a wholly owned subsidiary (the Securitization Subsidiary). The Securitization Subsidiary transfers variable undivided percentage interests in the receivables and related rights to certain third party financial institutions in exchange for cash proceeds, limited to the applicable funding capacities. Upon payment of the receivables by customers, rather than

remitting to the financial institutions the amounts collected, we retain such collections as proceeds for the sale of new receivables until payments become due to the third party financial institutions.

We account for the sale of the receivable interests as a secured borrowing on our Consolidated Balance Sheets. The receivables subject to the agreement collateralize the cash proceeds received from the third party financial institutions. We classify the entire outstanding balance as Long-term debt, net on our Consolidated Balance Sheets as we intend to refinance the obligations on a long-term basis. We present the receivables that collateralize the cash proceeds separately as Receivables pledged under receivables facility on our Consolidated Balance Sheets.

Cash Pooling Arrangement

Certain of our foreign subsidiaries entered into a cash pooling arrangement with a financial institution for cash management purposes. This arrangement allows the participating subsidiaries to withdraw cash from the financial institution to the extent that aggregate cash deposits held by these subsidiaries are available at the financial institution. To the extent the participating subsidiaries are in an overdraft position, such overdrafts are recorded as short-term borrowings under a committed cash overdraft facility. These borrowings bear interest at a variable rate based on the 3-month Euro Interbank Offered Rate (EURIBOR), plus a fixed margin. The facility has a seasonal maximum borrowing capacity of €12.0 million. We are required to pay a commitment fee, which is based on the borrowing capacity schedule. We pay this fee annually, in advance.

Australian Credit Facility

In the second quarter of 2017, PSL entered into a new credit facility, which provides a borrowing capacity of AU\$20.0 million, to fund expansion and supplement working capital needs. The facility balance at September 30, 2017 includes borrowings to fund the Newline Pool Products acquisition and the purchase of the noncontrolling interest.

Note 6 – Redeemable Noncontrolling Interest

As discussed in Note 1 - Summary of Significant Accounting Policies, in July 2014, we purchased a controlling interest in PSL. Included in the transaction documents was a put/call option deed that granted us an option to purchase the shares held by the noncontrolling interest, and granted the holder of the noncontrolling interest an option to require us to purchase its shares in one or two transactions. The put/call option deed in this transaction was considered an equity contract and therefore a financial instrument under the accounting guidance. In applying the guidance for this transaction, we determined that the financial instrument was embedded in the noncontrolling interest. As a public company, we were required to classify the noncontrolling interest and the embedded financial instrument as redeemable noncontrolling interest in a separate section of our Consolidated Balance Sheets, between liabilities and equity.

On June 29, 2017, we purchased the remaining 40% interest in PSL. The actual redemption value exceeded the carrying amount, and we recorded an adjustment to Additional paid in capital as there were no retained earnings attributable to the noncontrolling interest.

The table below presents the changes in Redeemable noncontrolling interest (in thousands):

	September 30,	
	2017	2016
Redeemable noncontrolling interest, beginning of period	\$2,287	\$2,665
Redemption value adjustment of noncontrolling interest	360	—
Net loss attributable to noncontrolling interest	(294)	(309)
Other comprehensive income attributable to noncontrolling interest	220	111
Less: purchase of redeemable noncontrolling interest	2,573	—
Redeemable noncontrolling interest, end of period	\$—	\$2,467

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with Management's Discussion and Analysis included in our 2016 Annual Report on Form 10-K.

For a discussion of our base business calculations, see the RESULTS OF OPERATIONS section below.

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

Our disclosure and analysis in this report contains forward-looking information that involves risks and uncertainties. Our forward looking statements express our current expectations or forecasts of possible future results or events, including projections of earnings and other financial performance measures, statements of management's expectations regarding our plans and objectives and industry, general economic and other forecasts of trends and other matters. Forward-looking statements speak only as of the date of this filing, and we undertake no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur. You can identify these statements by the fact that they do not relate strictly to historic or current facts and often use words such as "anticipate," "estimate," "expect," "believe," "will likely result," "outlook," "project," "should" and other words and expressions of similar meaning.

No assurance can be given that the results in any forward-looking statements will be achieved and actual results may differ materially due to one or more factors, including the sensitivity of our business to weather conditions, changes in the economy and the housing market, our ability to maintain favorable relationships with suppliers and manufacturers, competition from other leisure product alternatives and mass merchants, excess tax benefits or deficiencies recognized under ASU 2016-09 and other risks detailed in our 2016 Annual Report on Form 10-K. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act.

OVERVIEW

Financial Results

Our business performed very well in the third quarter of 2017, despite severe weather in Florida, Texas, Puerto Rico and Mexico from Hurricanes Irma, Harvey, Maria and Katia and despite the devastating earthquake in Mexico. While these events are disruptive in the short term, we believe they will not have a material impact on our operating results for the year.

Net sales increased 8% to \$743.4 million for the third quarter of 2017 compared to \$691.4 million in the third quarter of 2016. We realized base business sales growth of 6%. We had one less selling day in the third quarter of 2017 compared to the same period last year, which we believe negatively impacted base business sales growth by approximately 1%. Continued increases in swimming pool repair and remodel activities, including major pool refurbishment and replacement of key pool equipment, led our sales growth. The recent weather events negatively impacted our third quarter 2017 net sales by an estimated \$4.0 million.

Gross profit increased 9% for the third quarter of 2017 compared to the same period in 2016. Base business gross profit improved 7% over the third quarter of last year. Gross profit as a percentage of net sales (gross margin) increased approximately 20 basis points to 29.1% compared to the third quarter of 2016, reflecting product mix and benefits from sourcing initiatives.

Selling and administrative expenses (operating expenses) increased 7% compared to the third quarter of 2016, with base business operating expenses up 5% over the comparable 2016 period. As a percentage of net sales, base business

operating expenses declined to 17.9% for the third quarter versus 18.1% last year.

Operating income for the third quarter increased 10% compared to the same period in 2016. Operating income as a percentage of net sales (operating margin) was 11.0% for the third quarter of 2017 compared to 10.7% for the third quarter of 2016.

During the first quarter of 2017, we adopted Accounting Standards Update (ASU) 2016-09, Improvements to Employee Share-Based Payment Accounting, on a prospective basis. This adoption resulted in a benefit recorded in our Provision for income taxes of \$0.3 million for the three months ended September 30, 2017 and \$7.7 million for the nine months ended September 30, 2017, which positively impacted our net income and earnings per share, but was partially offset by a required increase of approximately 500,000 and 550,000 diluted weighted average shares outstanding, respectively, used to calculate our diluted earnings per share. The total first and second quarter benefit to our diluted earnings per share from the adoption of this new accounting pronouncement was \$0.14, and there was no impact in the third quarter of 2017.

Net income attributable to Pool Corporation was \$48.8 million in the third quarter of 2017 compared to \$44.5 million for the third quarter of 2016. Earnings per share increased to a record \$1.16 per diluted share for the three months ended September 30, 2017 versus \$1.03 per diluted share for the same period in 2016.

References to product line and product category data throughout this Form 10-Q generally reflect data related to the North American swimming pool market, as it is more readily available for analysis and represents the largest component of our operations.

Financial Position and Liquidity

Total net receivables, including pledged receivables, increased 13% from September 30, 2016, including a 2% increase from acquisitions. Our days sales outstanding (DSO), as calculated on a trailing four quarters basis, was 29.8 days at September 30, 2017, an improvement from 30.3 days at September 30, 2016, reflecting the effectiveness of our collection efforts. Our allowance for doubtful accounts balance was \$4.1 million at September 30, 2017 and \$3.7 million at September 30, 2016.

Net inventory levels grew 6% compared to levels at September 30, 2016. The inventory reserve was \$7.8 million at September 30, 2017 and \$8.1 million at September 30, 2016. Our inventory turns, as calculated on a trailing four quarters basis, were 3.5 times at both September 30, 2017 and September 30, 2016.

Total debt outstanding at September 30, 2017 was \$564.6 million, an increase of \$174.4 million, or 45%, compared to total debt at September 30, 2016, primarily because of share repurchases of \$199.0 million over the last 12 months, as well as debt incurred to fund business driven working capital growth.

Current Trends and Outlook

For a detailed discussion of trends through 2016, see the Current Trends and Outlook section of Management's Discussion and Analysis included in Item 7 of our 2016 Annual Report on Form 10-K.

In conjunction with the release of our first quarter 2017 results, we updated our 2017 earnings guidance from an initial range of \$3.80 to \$4.00 per diluted share to a range of \$4.12 to \$4.32 per diluted share, which reflected both an estimated benefit of \$0.30 due to the adoption of ASU 2016-09 and \$0.02 from better than expected first quarter 2017 operating results. We maintained this guidance following the release of our second quarter 2017 earnings results, which were largely in line with our expectations. Given changes in employee stock option exercise patterns in the third quarter of 2017, we updated our expectations for the remainder of 2017 to include only the \$0.14 tax benefit from ASU 2016-09 realized in the first and second quarters of 2017. Our operating results were in line with our expectations, and we have narrowed our earnings guidance to a range of \$4.01 to \$4.11 per diluted share. The estimated impact related to ASU 2016-09 is subject to several assumptions which can vary significantly, including our estimated share price and the period that our employees will exercise shares of outstanding vested options.

We project base business sales growth of 6% to 7% for the full year and expect gross margin to be similar to 2016, including an expected decline in gross margin in the fourth quarter of 2017 due to anticipated product mix changes following major third quarter weather events as well as an unfavorable comparison to fourth quarter 2016 results, which benefited by 20 basis points from an increase in the vendor incentive accrual at year-end. For the year, we have incurred growth-driven expense increases related to labor, facilities expansion and delivery costs, although the growth in these types of operating expenses has moderated as we have moved throughout the year. We expect base business operating expenses as a percentage of net sales for 2017 to decline between 20 and 40 basis points as compared to 2016, resulting in a 20 to 40 basis points increase in base business operating income as a percentage of net sales.

Given our \$174.4 million increase in debt as of September 30, 2017 over the prior year and the increase in 30-Day LIBOR of approximately 70 basis points over last year, we expect our Interest and other non-operating expenses, net for the full year 2017 to increase by approximately \$1.5 million to \$2.0 million over 2016, depending on fourth quarter borrowings to fund future share repurchases.

Excluding the impact from the adoption of ASU 2016-09, we expect our effective tax rate will be consistent with 2016. Our effective tax rate is dependent upon our results of operations and may change if actual results are different from our current expectations, particularly any significant changes in our geographic mix. Due to the adoption of the new accounting standard, we expect our effective tax rate will fluctuate from quarter to quarter, particularly in periods when employees elect to exercise their vested stock options or when restrictions on share-based awards lapse. Based on our comparison of our deferred tax assets for share-based compensation to the current intrinsic value of the underlying awards, we expect to recognize material income tax benefits in periods when these transactions occur. The impact related to ASU 2016-09 is subject to several variables, including our share price and the period in which our employees will exercise shares of outstanding vested options.

We expect cash provided by operations will exceed net income for the 2017 fiscal year. We anticipate that we may use approximately \$140.0 million to \$160.0 million in cash to fund share repurchases in 2017.

RESULTS OF OPERATIONS

As of September 30, 2017, we conducted operations through 346 sales centers in North America, Europe, South America and Australia.

The following table presents information derived from the Consolidated Statements of Income expressed as a percentage of net sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	70.9	71.1	71.0	71.1
Gross profit	29.1	28.9	29.0	28.9
Operating expenses	18.1	18.1	17.2	17.3
Operating income	11.0	10.7	11.7	11.6
Interest and other non-operating expenses, net	0.5	0.4	0.5	0.5
Income before income taxes and equity earnings	10.5 %	10.3 %	11.2 %	11.1 %

Note: Due to rounding, percentages may not add to Operating income or Income before income taxes and equity earnings.

We have included the results of operations from the acquisitions in 2017 and 2016 in our consolidated results since the acquisition dates.

Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016

The following table breaks out our consolidated results into the base business component and the excluded component (sales centers excluded from base business):

(Unaudited) (in thousands)	Base Business		Excluded		Total	
	Three Months Ended		Three Months Ended		Three Months Ended	
	September 30, 2017	2016	September 30, 2017	2016	September 30, 2017	2016
Net sales	\$734,175	\$691,204	\$9,226	\$225	\$743,401	\$691,429
Gross profit	213,788	199,455	2,818	96	216,606	199,551
Gross margin	29.1	% 28.9	% 30.5	% 42.7	% 29.1	% 28.9
Operating expenses	131,066	125,225	3,612	160	134,678	125,385
Expenses as a % of net sales	17.9	% 18.1	% 39.2	% 71.1	% 18.1	% 18.1
Operating income (loss)	82,722	74,230	(794)	(64)	81,928	74,166
Operating margin	11.3	% 10.7	% (8.6)	% (28.4)	% 11.0	% 10.7

In our calculation of base business results, we have excluded the following acquisitions for the periods identified:

Acquired	Net		Periods
	Acquisition Date	Sales Centers Acquired	
New Star Holdings Pty. Ltd.	July 2017	1	July - September 2017
Lincoln Aquatics ⁽¹⁾	April 2017	2	July - September 2017

⁽¹⁾ We acquired certain distribution assets of this company.

When calculating our base business results, we exclude sales centers that are acquired, closed, or opened in new markets for a period of 15 months. We also exclude consolidated sales centers when we do not expect to maintain the majority of the existing business and existing sales centers that are consolidated with acquired sales centers.

We generally allocate corporate overhead expenses to excluded sales centers on the basis of their net sales as a percentage of total net sales. After 15 months of operations, we include acquired, consolidated and new market sales centers in the base business calculation including the comparative prior year period.

The table below summarizes the changes in our sales center count during the first nine months of 2017:

December 31, 2016	344
Acquired locations	3
New location	1
Closed locations	(2)
September 30, 2017	346

Net Sales

	Three Months Ended September 30,		
(in millions)	2017	2016	Change
Net sales	\$743.4	\$691.4	\$52.0 8%

Net sales increased 8% in the third quarter of 2017 compared to the third quarter of 2016, with base business sales up 6% for the period. Severe weather events during the third quarter of this year, particularly Hurricanes Irma and Harvey, were the most disruptive impact to our sales growth. Sales in Texas largely recovered by the end of the quarter, but sales in Florida remain behind the growth levels experienced prior to Hurricane Irma. We estimate these recent weather events negatively impacted net sales by approximately \$4.0 million. Our seasonal markets generated sales growth of 6% during the quarter.

The following factors positively impacted our sales growth (listed in order of estimated magnitude):

- continued consumer investments in enhancing outdoor living spaces, as evidenced by improvements in sales growth rates for product offerings such as building materials and equipment (see discussion below);
- market share gains;
- pool and spa chemical sales, our largest product category at 14% of total net sales for the quarter, increased 2% over the third quarter of 2016 under less attractive weather conditions in 2017 and excluding the recent Lincoln Aquatics acquisition; and
- inflationary product cost increases (estimated at close to 1%).

The following factors negatively impacted our sales growth (listed in order of estimated magnitude):

- one less selling day in the third quarter of 2017 compared to the same period last year, affecting net sales growth approximately 1%; and
- recent weather events (described above).

We believe that sales growth rates for certain product offerings, such as building materials and equipment, evidence increased spending in traditionally discretionary areas including pool construction and pool remodeling, as well as equipment upgrades. In the third quarter of 2017, the sales growth rate for equipment, such as swimming pool heaters, pumps, lights and filters, collectively, was similar to the 8% growth rate for total net sales compared to the third quarter of 2016. This increase reflects both the ongoing recovery of replacement activity and continued demand for higher-priced, more energy-efficient products. Sales of building materials, which includes tile, represent approximately 10% of net sales for the third quarter of 2017 and grew by 9% compared to the third quarter of 2016.

Sales to customers who service large commercial swimming pool installations such as hotels, universities and community recreational facilities are included in the appropriate existing product categories and growth in this area is reflected in the numbers above. These sales represented just over 4% of our consolidated net sales for the third quarter of 2017 and increased 12% compared to the third quarter of 2016, excluding the recent acquisition of Lincoln Aquatics. With Lincoln Aquatics, commercial sales represent approximately 5% of our consolidated net sales, and this acquisition furthers our efforts to increase not only our focus on the commercial market, but also the resources assigned to this area, including designated warehouse space, increased staffing and additional vendor relationships.

Gross Profit

Three Months
Ended

	September 30,		
(in millions)	2017	2016	Change
Gross profit	\$216.6	\$199.6	\$17.0 9%
Gross margin	29.1 %	28.9 %	

Gross margin for the third quarter of 2017 increased approximately 20 basis points compared to the third quarter of 2016. This increase primarily reflects product mix and benefits from sourcing initiatives.

Operating Expenses

(in millions)	Three Months Ended September 30,		
	2017	2016	Change
Operating expenses	\$134.7	\$125.4	\$9.3 7%
Operating expenses as a % of net sales	18.1 %	18.1 %	

Operating expenses increased 7% in the third quarter of 2017 compared to the third quarter of 2016, with base business operating expenses up 5% compared to the same period last year. Increased growth-driven labor and freight expenses, as well as higher performance-based and equity-based compensation costs comprised the majority of our operating expense growth. As a percentage of net sales, base business operating expenses declined to 17.9% for the third quarter versus 18.1% last year.

Interest and Other Non-operating Expenses, Net

Interest and other non-operating expenses, net increased \$1.0 million compared to the third quarter of 2016, primarily due to higher interest rates on our debt and an increase in borrowings. Our weighted average effective interest rate increased to 2.7% for the third quarter of 2017 from 2.0% for the third quarter of 2016 on higher average outstanding debt of \$535.5 million versus \$426.7 million for the respective periods.

Income Taxes

Our effective income tax rate was 37.4% for the three months ended September 30, 2017 and 37.7% for the three months ended September 30, 2016. Our third quarter effective income tax rate is typically lower compared to other quarters, primarily due to the timing of our accounting for uncertain tax positions, including the expiration of statutes of limitations. The decline also reflects a \$0.3 million tax benefit recorded in our provision for income taxes from the adoption of ASU 2016-09.

Net Income and Earnings Per Share

Net income attributable to Pool Corporation increased 10% to \$48.8 million in the third quarter of 2017 compared to the third quarter of 2016. Earnings per diluted share increased to \$1.16 for the third quarter of 2017 versus \$1.03 per diluted share for the comparable period in 2016. The adoption of ASU 2016-09 did not have an impact our earnings per diluted share in the third quarter of 2017.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

The following table breaks out our consolidated results into the base business component and the excluded component (sales centers excluded from base business):

(Unaudited) (in thousands)	Base Business		Excluded		Total		
	Nine Months Ended September 30,		Nine Months Ended September 30,		Nine Months Ended September 30,		
	2017	2016	2017	2016	2017	2016	
Net sales	\$2,246,446	\$2,116,393	\$31,559	\$9,175	\$2,278,005	\$2,125,568	
Gross profit	650,419	610,454	9,472	2,856	659,891	613,310	
Gross margin	29.0	% 28.8	% 30.0	% 31.1	% 29.0	% 28.9	%
Operating expenses	383,636	365,287	9,143	1,907	392,779	367,194	
Expenses as a % of net sales	17.1	% 17.3	% 29.0	% 20.8	% 17.2	% 17.3	%
Operating income	266,783	245,167	329	949	267,112	246,116	
Operating margin	11.9	% 11.6	% 1.0	% 10.3	% 11.7	% 11.6	%

In our calculation of base business results, we have excluded the following acquisitions for the periods identified:

Acquired	Acquisition Date	Net Sales Centers Acquired	Periods Excluded
Lincoln Aquatics ⁽¹⁾	April 2017	2	May - September 2017
Metro Irrigation Supply Company Ltd. ⁽¹⁾	April 2016	8	January - June 2017 and April - June 2016
The Melton Corporation ⁽¹⁾	November 2015	2	January 2017 and January 2016
Seaboard Industries, Inc. ⁽¹⁾	October 2015	3	January 2017 and January 2016

⁽¹⁾ We acquired certain distribution assets of each of these companies.

For a more detailed explanation of how we calculated base business results and a summary of the changes in our sales centers since December 31, 2016, please refer to the discussion under the heading Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016.

Net Sales

	Nine Months Ended September 30,		
(in millions)	2017	2016	Change
Net sales	\$2,278.0	\$2,125.6	\$152.4 7%

Net sales for the first nine months of 2017 increased 7% compared to the same period last year, with much of this growth resulting from the 6% improvement in base business sales.

The following factors contributed to our sales growth (listed in order of estimated magnitude):

- continued improvement in consumer discretionary expenditures, including market recovery in remodeling and replacement activity (see discussion below);
- market share growth, particularly in building materials and commercial product categories;
- pool and spa chemical sales, our largest product category at 13% of total net sales for the nine months ended September 30, 2017, increased 3% compared to the first nine months of 2016, excluding the recent Lincoln Aquatics acquisition; and
- inflationary (estimated at close to 1%) product cost increases.

We believe that sales growth rates for certain product offerings, such as building materials and equipment, evidence increased spending in traditionally discretionary areas including pool construction, pool remodeling, as well as equipment upgrades. In the first nine months of 2017, the sales growth rate for equipment, such as swimming pool heaters, pumps, lights and filters, collectively, was similar to the 7% growth rate for total net sales compared to the same period in 2016. This increase reflects both the ongoing recovery of replacement activity and continued demand for higher-priced, more energy-efficient products. Sales of building materials, which includes tile, represent approximately 11% of net sales for the first nine months of 2017 and grew by 12% compared to the first nine months of 2016.

Sales to customers who service large commercial installations such as hotels, universities and community recreational facilities are included in the appropriate existing product categories and growth in this area is reflected in the numbers above. These sales represented 4% of our consolidated net sales for the first nine months of 2017 and increased 12% compared to the same period in 2016, excluding the recent acquisition of Lincoln Aquatics.

Gross Profit

	Nine Months Ended September 30,		
(in millions)	2017	2016	Change
Gross profit	\$659.9	\$613.3	\$46.6 8%
Gross margin	29.0 %	28.9 %	

Gross margin for the nine months ended September 30, 2017 was in line with gross margin for the nine months ended September 30, 2016.

Operating Expenses

(in millions)	Nine Months Ended September 30,		
	2017	2016	Change
Operating expenses	\$392.8	\$367.2	\$25.6 7%
Operating expenses as a % of net sales	17.2 %	17.3 %	

For the first nine months of 2017, operating expenses were up 7% over the same period last year, with base business operating expenses up 5%. The increase in base business operating expenses was primarily due to higher growth-driven labor and freight expenses, as well as greater employee-related health insurance costs, equity-based compensation, and technology spending as we continue to invest in our business. Operating expenses as a percentage of net sales was consistent for the first nine months of 2017 and 2016 and improved by 20 basis points on a base business basis.

Interest and Other Non-operating Expenses, Net

Interest and other non-operating expenses, net for the first nine months of 2017 increased \$1.7 million compared to the same period last year, primarily due to higher interest rates on our debt and an increase in borrowings. Our weighted average effective interest rate increased to 2.6% for the first nine months of 2017 from 2.0% for the same period of 2016 on higher average outstanding debt of \$501.0 million versus \$437.3 million for the respective periods.

Income Taxes

Our effective income tax rate was 35.2% for the nine months ended September 30, 2017 compared to 38.2% for the nine months ended September 30, 2016. The decline in our effective income tax rate is primarily due to the \$7.7 million tax benefit recorded in our provision for income taxes, which reflects the impact of the adoption of ASU 2016-09.

Net Income and Earnings Per Share

Earnings per share for the first nine months of 2017, including a favorable \$0.14 per diluted share impact from the adoption of ASU 2016-09, increased to \$3.89 per diluted share on Net income attributable to Pool Corporation of \$166.0 million, compared to \$3.39 per diluted share on Net income attributable to Pool Corporation of \$146.3 million in the comparable 2016 period.

Seasonality and Quarterly Fluctuations

Our business is highly seasonal. In general, sales and operating income are highest during the second and third quarters, which represent the peak months of both swimming pool use and installation and landscape maintenance and installation. Sales are substantially lower during the first and fourth quarters, when we may incur net losses. In 2016, we generated approximately 63% of our net sales and 85% of our operating income in the second and third quarters of the year.

We typically experience a build-up of product inventories and accounts payable during the winter months in anticipation of the peak selling season. Excluding borrowings to finance acquisitions and share repurchases, our peak borrowing usually occurs during the second quarter, primarily because extended payment terms offered by our suppliers typically are payable in April, May and June, while our peak accounts receivable collections typically occur in June, July and August.

The following table presents certain unaudited quarterly data for the first, second and third quarters of 2017, the four quarters of 2016 and the fourth quarter of 2015. We have included income statement and balance sheet data for the most recent eight quarters to allow for a meaningful comparison of the seasonal fluctuations in these amounts. In our opinion, this information reflects all normal and recurring adjustments considered necessary for a fair presentation of this data. Due to the seasonal nature of our industry, the results of any one or more quarters are not necessarily a good indication of results for an entire fiscal year or of continuing trends.

(Unaudited) (in thousands)	QUARTER							
	2017			2016		2015		
	Third	Second	First	Fourth	Third	Second	First	Fourth
Statement of Income Data								
Net sales	\$743,401	\$988,163	\$546,441	\$445,235	\$691,429	\$918,889	\$515,250	\$415,075
Gross profit	216,606	289,664	153,621	127,777	199,551	270,736	143,023	118,295
Operating income	81,928	154,186	30,998	9,743	74,166	142,420	29,530	5,979
Net income	48,783	94,620	22,270	2,572	44,421	85,247	16,363	2,579
Balance Sheet Data								
Total receivables, net	\$262,796	\$370,285	\$290,019	\$166,151	\$233,405	\$351,012	283,758	\$156,756
Product inventories, net	484,287	542,805	647,884	486,116	455,156	493,254	595,393	474,275
Accounts payable	209,062	273,309	465,928	230,728	199,922	265,349	438,705	246,554
Total debt	564,573	553,480	490,217	438,042	390,189	500,606	450,457	328,045

We expect that our quarterly results of operations will continue to fluctuate depending on the timing and amount of revenue contributed by new and acquired sales centers. Based on our peak summer selling season, we generally open new sales centers and close or consolidate sales centers, when warranted, either in the first quarter before the peak selling season begins or in the fourth quarter after the peak selling season ends.

Weather is one of the principal external factors affecting our business. The table below presents some of the possible effects resulting from various weather conditions.

Weather	Possible Effects
Hot and dry	<ul style="list-style-type: none"> • Increased purchases of chemicals and supplies for existing swimming pools • Increased purchases of above-ground pools and irrigation products
Unseasonably cool weather or extraordinary amounts of rain	<ul style="list-style-type: none"> • Fewer pool and landscape installations • Decreased purchases of chemicals and supplies • Decreased purchases of impulse items such as above-ground pools and accessories
Unseasonably early warming trends in spring/late cooling trends in fall (primarily in the northern half of the U.S. and Canada)	<ul style="list-style-type: none"> • A longer pool and landscape season, thus positively impacting our sales
Unseasonably late warming trends in spring/early cooling trends in fall (primarily in the northern half of the U.S. and Canada)	<ul style="list-style-type: none"> • A shorter pool and landscape season, thus negatively impacting our sales

Weather Impacts on 2017 and 2016 Results

Severe storms in the third quarter of 2017, particularly Hurricanes Irma and Harvey, hindered our sales growth in Florida and Texas, although Texas largely recovered by the end of September. In the Central and Midwest, temperatures were normal for this time of year, contrasting with the above-average temperatures in the third quarter of 2016. The West experienced record heat and normal rainfall in the third quarter of 2017, similar to the above average heat in the same period last year.

Cold and wet weather throughout the Mid-South and North impacted those seasonal markets in the middle of the second quarter, while the weather impact overall for the quarter was fairly neutral. Temperatures and precipitation throughout most areas other than those described above, were normal, with only Texas benefiting from drier weather in the second quarter of 2017 compared to the above average rainfall experienced in the same period of 2016.

Unseasonably mild weather benefited sales in the first quarter of 2017. However, while favorable weather trends early in the year normally have a seasonally larger impact, the comparison to the first quarter of 2016 was especially tough given the benefit of the warmer-than-normal weather across nearly all markets in the United States in the first quarter of 2016. For the first quarter of 2017, Texas and surrounding markets experienced record warm temperatures, which when coupled with below-average precipitation for that area, spurred higher sales growth. In two of the more seasonal regions where we operate, below-average temperatures in the North and above-average precipitation in the West negatively impacted our first quarter 2017 sales growth.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is defined as the ability to generate adequate amounts of cash to meet short-term and long-term cash needs. We assess our liquidity in terms of our ability to generate cash to fund our operating activities, taking into consideration the seasonal nature of our business. Significant factors which could affect our liquidity include the following:

- cash flows generated from operating activities;
- the adequacy of available bank lines of credit;
- acquisitions;
- scheduled debt payments;
- dividend payments;
- capital expenditures;
- the timing and extent of share repurchases; and
- the ability to attract long-term capital with satisfactory terms.

Our primary capital needs are seasonal working capital requirements and other general corporate purposes, including acquisitions, dividend payments and share repurchases. Our primary sources of working capital are cash from operations supplemented by borrowings, which have historically been sufficient to support our growth and finance acquisitions. The same principle applies to funds used for capital expenditures and share repurchases.

We prioritize our use of cash based on investing in our business, maintaining a prudent debt structure and returning money to our shareholders. Our specific priorities for the use of cash are as follows:

- maintenance and new sales center capital expenditures;
- strategic acquisitions executed opportunistically;
- payment of cash dividends as and when declared by our Board of Directors (Board);
- repayment of debt to maintain an average total leverage ratio (as defined below) between 1.5 and 2.0; and
- repurchases of our common stock under our Board authorized share repurchase program.

For 2017, we project capital expenditures will be approximately 1.5% of net sales as we expand facilities and purchase delivery vehicles to address growth opportunities. Over the last five years, capital expenditures have averaged roughly 1.0% of net sales. Capital expenditures were 1.4% of net sales in 2016, 1.0% of net sales in 2015 and 0.8% of sales in 2014.

Sources and Uses of Cash

The following table summarizes our cash flows (in thousands):

	Nine Months Ended	
	September 30,	
	2017	2016
Operating activities	\$ 112,020	\$ 143,170
Investing activities	(44,584)	(50,233)
Financing activities	(52,746)	(75,697)

Cash provided by operating activities of \$112.0 million decreased during the first nine months of 2017 compared to the first nine months of 2016 due to a combination of growth-related increases in inventories and receivables and the payment of our normal scheduled payment of our third quarter estimated taxes. These estimated payments for the third quarter of 2016 were deferred as allowed for areas affected by severe storms and flooding in Louisiana.

Cash used in investing activities for the first nine months of 2017 decreased compared to the first nine months of 2016. While we made increased investments in capital expenditures for vehicle additions in the first nine months of 2017, our cash used for acquisitions was considerably lower in the current period.

Cash used in financing activities decreased for the first nine months of 2017 compared to the first nine months of 2016, which reflects a \$65.4 million increase in amounts provided by net borrowings, partially offset by a \$23.7 million increase in amounts used for share repurchases. Dividends paid to shareholders increased by \$6.2 million in the first nine months of 2017 compared to the first nine months of 2016.

Future Sources and Uses of Cash

Revolving Credit Facility

On September 29, 2017, we amended and restated our existing senior credit facility (the Credit Facility) principally in the following ways:

- extends the maturity date to September 29, 2022;
- increases the borrowing capacity to \$750.0 million from \$465.0 million;
- increases sublimits for swingline loans;
- decreases the pricing of all loans; and
- provides additional capacity under certain negative covenants related to indebtedness, liens, investments and dispositions of assets.

Pursuant to an accordion feature, the aggregate maximum principal amount of the commitments under the Credit Facility may be increased at our request and with agreement by the lenders by up to \$75.0 million, to a total of \$825.0 million. We intend to use the Credit Facility for general corporate purposes, for future share repurchases and to fund future growth initiatives.

At September 30, 2017, there was \$415.3 million outstanding, a \$4.2 million standby letter of credit outstanding and \$330.5 million available for borrowing under the Credit Facility. 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 the Credit Facility. As of September 30, 2017, we have three interest rate swap contracts in place that became effective on October 19, 2016. These swap contracts were previously forward-starting and were amended in October 2015 to bring the fixed rates per our forward-starting contracts in line with current market rates and extend the hedged period for future interest payments on our Credit Facility. Now effective, these amended swap contracts convert the Credit Facility's variable interest rate to fixed rates of 2.273% on a notional amount of \$75.0 million and 2.111% on two separate notional amounts, one \$25.0 million and the other \$50.0 million, totaling \$75.0 million. Interest expense related to the notional amounts under these swap contracts is based on the fixed rates plus the applicable margin on the Credit Facility. These interest rate swap contracts will terminate on November 20, 2019.

In July 2016 we entered into a forward-starting interest rate swap contract to extend the hedged period for future interest payments on our Credit Facility to its maturity date at that time. This swap contract will convert the Credit Facility's variable interest rate to a fixed rate of 1.1425% on a notional amount of \$150.0 million. The contract becomes effective on November 20, 2019 and terminates on November 20, 2020.

The weighted average effective interest rate for the Credit Facility as of September 30, 2017 was approximately 2.7%, excluding commitment fees.

Financial covenants on the Credit Facility include maintenance of a maximum average total leverage ratio and a minimum fixed charge coverage ratio. As of September 30, 2017, the calculations of these two covenants are detailed below:

Maximum Average Total Leverage Ratio. On the last day of each fiscal quarter, our average total leverage ratio must be less than 3.25 to 1.00. Average Total Leverage Ratio is the ratio of the trailing twelve months (TTM) Average Total Funded Indebtedness plus the TTM Average Accounts Securitization Proceeds divided by the TTM EBITDA (as those terms are defined in the Credit Facility). As of September 30, 2017, our average total leverage ratio equaled 1.60 (compared to 1.54 as of June 30, 2017) and the TTM average total debt amount used in this calculation was \$496.5 million.

Minimum Fixed Charge Coverage Ratio. On the last day of each fiscal quarter, our fixed charge ratio must be greater than or equal to 2.25 to 1.00. Fixed Charge Ratio is the ratio of the TTM EBITDAR divided by TTM Interest Expense paid or payable in cash plus TTM Rental Expense (as those terms are defined in the Credit Facility). As of September 30, 2017, our fixed charge ratio equaled 5.50 (compared to 5.52 as of June 30, 2017) and TTM Rental Expense was \$53.5 million.

The Credit Facility also limits the declaration and payment of dividends on our common stock to no more than 50% of the preceding year's Net Income (as defined in the Credit Facility), provided no default or event of default has occurred and is continuing, or would result from the payment of dividends. Additionally, we may declare and pay quarterly dividends notwithstanding that the aggregate amount of dividends paid would be in excess of the 50% limit described above so long as (i) the amount per share of such dividends does not exceed the amount per share paid during the most recent fiscal year in which we were in compliance with the 50% limit and (ii) our Average Total Leverage Ratio is less than 3.00 to 1.00 both immediately before and after giving pro forma effect to such dividends. Further, dividends must be declared and paid in a manner consistent with our past practice.

Under the Credit Facility, we may repurchase shares of our common stock provided no default or event of default has occurred and is continuing, or would result from the repurchase of shares, and our maximum average total leverage ratio (determined on a pro forma basis) is less than 2.50 to 1.00. Other covenants include restrictions on our ability to grant liens, incur indebtedness, make investments, merge or consolidate, and sell or transfer assets. Failure to comply with any of our financial covenants or any other terms of the Credit Facility could result in penalty payments, higher interest rates on our borrowings or the acceleration of the maturities of our outstanding debt.

Receivables Securitization Facility

Our two-year Receivables Facility offers us a lower cost form of financing, with a peak funding capacity of up to \$220.0 million between May 1 and June 30, which includes an additional seasonal funding capacity that is available between March 1 and July 31. Other funding capacities range from \$65.0 million to \$150.0 million throughout the remaining months of the year.

The Receivables Facility provides for the sale of certain of our receivables to a wholly owned subsidiary (the Securitization Subsidiary). The Securitization Subsidiary transfers variable undivided percentage interests in the receivables and related rights to certain third party financial institutions in exchange for cash proceeds, limited to the applicable funding capacities. Upon payment of the receivables by customers, rather than remitting to the financial institutions the amounts collected, we retain such collections as proceeds for the sale of new receivables until payments become due.

The Receivables Facility contains terms and conditions (including representations, covenants and conditions precedent) customary for transactions of this type. Additionally, an amortization event will occur if we fail to maintain a maximum average total leverage ratio (average total funded debt/EBITDA) of 3.25 to 1.00 and a minimum fixed charge coverage ratio (EBITDAR/cash interest expense plus rental expense) of 2.25 to 1.00.

At September 30, 2017, there was \$142.3 million outstanding under the Receivables Facility at a weighted average effective interest rate of 2.0%, excluding commitment fees.

As of September 30, 2017, we were in compliance with all covenants and financial ratio requirements under our Credit Facility and our Receivables Facility. We believe we will remain in compliance with all covenants and financial ratio requirements throughout the next twelve months. For additional information regarding our debt arrangements, see Note 5 of "Notes to Consolidated Financial Statements," included in Item 8 of our 2016 Annual Report on Form 10-K.

We believe we have adequate availability of capital to fund present operations and the current capacity to finance any working capital needs that may arise. We continually evaluate potential acquisitions and hold discussions with acquisition candidates. If suitable acquisition opportunities arise that would require financing, we believe that we have the ability to finance any such transactions.

As of October 26, 2017, \$53.4 million of the current Board authorized amount under our share repurchase program remained available. We expect to repurchase additional shares on the open market from time to time depending on market conditions. We plan to fund these repurchases with cash provided by operations and borrowings under the credit and receivables facilities.

CRITICAL ACCOUNTING ESTIMATES

We prepare our Consolidated Financial Statements in accordance with U.S. generally accepted accounting principles (GAAP), which require management to make estimates and assumptions that affect reported amounts and related disclosures. Management identifies critical accounting estimates as:

- those that require the use of assumptions about matters that are inherently and highly uncertain at the time the estimates are made; and

- those for which changes in the estimate or assumptions, or the use of different estimates and assumptions, could have a material impact on our consolidated results of operations or financial condition.

Management has discussed the development, selection and disclosure of our critical accounting estimates with the Audit Committee of our Board. For a description of our critical accounting estimates that require us to make the most difficult, subjective or complex judgments, please see our 2016 Annual Report on Form 10-K. We have not changed these policies from those previously disclosed.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (ASU 2014-09). The FASB also issued subsequent amendments to ASU 2014-09 to provide clarification on the guidance. ASU 2014-09 will be effective for annual periods beginning after December 15, 2017, which for us will be in the period beginning January 1, 2018. We are continuing to perform our detailed evaluation, using a five-step model specified in the guidance, to assess the impacts of the new standard.

Under the new standard, revenue will be recognized when we satisfy our performance obligation by transferring promised products or services to our customer. The standard allows for application of the guidance to a portfolio of contracts or performance obligations with similar characteristics. Since our individual sales transactions are very similar in nature, we anticipate applying the guidance to all transactions as a portfolio. We expect that the effects of applying this guidance to the portfolio would not differ materially from applying the guidance to individual performance obligations within that portfolio.

Our revenue recognition will be achieved upon delivery of products as there are no other promised services as part of our contracts with customers that are material in the context of the contract. Because our shipping and handling activities are performed before the customer obtains control of the goods, we do not consider these activities to be a promised service to the customer. Rather shipping and handling are activities to fulfill our promise to transfer the goods. Product warranties do not constitute a performance obligation for us, as products are warranted directly by the manufacturer or the third party carrier.

To determine the amount of consideration to which we expect to be entitled in exchange for transferring promised goods, we have considered if variable consideration exists. We have reviewed our standard terms and conditions and our customary business practices to determine the transaction price. We have reviewed our pricing policies including marketing programs, coupons and free products for the purpose of determining whether we have any variable or non-cash consideration. We do not issue future-dated coupons or free product rebates. When we process manufacturer coupons, we record the customer sales price as revenue and receive reimbursement of the coupon value from the manufacturer. In addition, we reviewed our current accounting policies related to returns and price concessions for which no material changes in policy were noted. Volume rebates is a sales incentive program where we make a cash payment or apply credit to a customer account on a quarterly or annual basis, if the customer reaches a specified level of purchases. The volume rebates are accounted for as a reduction of the transaction price, and a liability is recorded until the related payment to the customer is made. We do not offer any volume discounts. We will continue our accounting policy election to exclude from revenue all amounts we collect and remit to governmental authorities. The majority of our sales transactions do not require any additional performance obligation after delivery, therefore we do not have multiple performance obligations for which we will have to allocate the transaction price. We do not offer customer loyalty programs.

We expect to recognize revenue when control of the product has been transferred to the customer upon delivery to the customer or the freight carrier, if delivered by a third party, as we believe our performance obligation will be satisfied at that point in time.

We expect to apply the guidance using the modified retrospective transition method. Based on our analysis performed to date, we do not expect the adoption of ASU 2014-09 will have a material impact on our financial position or results of operations, but we expect it will result in additional disclosures regarding our revenue recognition policies. We also do not expect the adoption will require material or significant changes to our internal controls over financial reporting. We have expanded our revenue recognition inquiries to additional departments and updated our questionnaires primarily to identify matters that would signal variable consideration implications under the new guidance. We are also in the process of drafting additional pricing policies to address potential revenue recognition implications.

In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to record most leases on their balance sheets but recognize expenses in a manner similar to current guidance. ASU 2016-02 will be effec