

POOL CORP
Form 10-Q
October 30, 2014

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
^x 1934

For the quarterly period ended September 30, 2014

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
(State or other jurisdiction of
incorporation or organization)

36-3943363
(I.R.S. Employer
Identification No.)

109 Northpark Boulevard,
Covington, Louisiana
(Address of principal executive offices)

70433-5001
(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

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

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, 2014, there were 43,424,783 shares of common stock outstanding.

POOL CORPORATION
Form 10-Q
For the Quarter Ended September 30, 2014

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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,	
	2014	2013	2014	2013
Net sales	\$615,536	\$578,157	\$1,870,120	\$1,738,911
Cost of sales	439,292	415,600	1,332,800	1,243,427
Gross profit	176,244	162,557	537,320	495,484
Selling and administrative expenses	117,787	109,182	347,718	323,184
Operating income	58,457	53,375	189,602	172,300
Interest expense, net	1,864	1,544	5,691	5,239
Income before income taxes and equity earnings (loss)	56,593	51,831	183,911	167,061
Provision for income taxes	21,711	19,496	71,111	64,808
Equity earnings (loss) in unconsolidated investments	76	(3) 209	52
Net income	34,958	32,332	113,009	102,305
Less: net income attributable to noncontrolling interest	(122) —	(122) —
Net income attributable to Pool Corporation	\$34,836	\$32,332	\$112,887	\$102,305
Earnings per share:				
Basic	\$0.80	\$0.70	\$2.53	\$2.20
Diluted	\$0.78	\$0.68	\$2.47	\$2.14
Weighted average shares outstanding:				
Basic	43,756	46,380	44,563	46,475
Diluted	44,864	47,598	45,730	47,720
Cash dividends declared per common share	\$0.22	\$0.19	\$0.63	\$0.54

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, 2014	2013	September 30, 2014	2013
Net income	\$34,958	\$32,332	\$113,009	\$102,305
Other comprehensive income (loss):				
Foreign currency translation adjustments	(2,216)	(128)	(2,671)	(361)
Change in unrealized gains and losses on interest rate swaps, net of tax of \$(399), \$187, \$(260) and \$(582)	625	(291)	407	913
Total other comprehensive income (loss)	(1,591)	(419)	(2,264)	552
Comprehensive income	33,367	31,913	110,745	102,857
Less: comprehensive income attributable to noncontrolling interest	(13)	—	(13)	—
Comprehensive income attributable to Pool Corporation	\$33,354	\$31,913	\$110,732	\$102,857

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

POOL CORPORATION

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2014 (Unaudited)	September 30, 2013 (Unaudited)	December 31, 2013 ⁽¹⁾
Assets			
Current assets:			
Cash and cash equivalents	\$ 14,455	\$ 24,222	\$ 8,006
Receivables, net	69,847	180,898	45,138
Receivables pledged under receivables facility	137,318	—	80,149
Product inventories, net	414,331	365,596	429,197
Prepaid expenses and other current assets	10,561	9,474	9,802
Deferred income taxes	5,378	3,742	5,457
Total current assets	651,890	583,932	577,749
Property and equipment, net	57,260	51,537	52,328
Goodwill	174,607	169,983	171,974
Other intangible assets, net	12,433	10,390	10,196
Equity interest investments	1,289	1,112	1,243
Other assets, net	11,757	9,920	10,271
Total assets	\$ 909,236	\$ 826,874	\$ 823,761
Liabilities, redeemable noncontrolling interest and stockholders' equity			
Current liabilities:			
Accounts payable	\$ 154,511	\$ 142,777	\$ 214,596
Accrued expenses and other current liabilities	75,222	64,737	49,301
Current portion of long-term debt and other long-term liabilities	2,618	15	9
Total current liabilities	232,351	207,529	263,906
Deferred income taxes	19,934	15,463	19,108
Long-term debt	391,120	260,432	246,418
Other long-term liabilities	10,027	7,619	8,147
Total liabilities	653,432	491,043	537,579
Redeemable noncontrolling interest	3,144	—	—
Stockholders' equity:			
Common stock, \$0.001 par value; 100,000,000 shares authorized; 43,352,818, 46,068,927 and 45,378,785 shares issued and outstanding at September 30, 2014, September 30, 2013 and December 31, 2013, respectively	43	46	45
Additional paid-in capital	329,588	305,831	310,503
Retained (deficit) earnings	(77,619)) 29,536	(27,278)
Accumulated other comprehensive income	648	418	2,912
Total stockholders' equity	252,660	335,831	286,182
	\$ 909,236	\$ 826,874	\$ 823,761

Total liabilities, redeemable noncontrolling interest and stockholders' equity

(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,	
	2014	2013
Operating activities		
Net income	\$ 113,009	\$ 102,305
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,749	9,716
Amortization	1,075	922
Share-based compensation	6,854	6,090
Excess tax benefits from share-based compensation	(4,141)	(4,367)
Equity earnings in unconsolidated investments	(209)	(52)
Other	(727)	(194)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Receivables	(79,891)	(65,638)
Product inventories	19,262	34,709
Prepaid expenses and other assets	(1,212)	1,063
Accounts payable	(61,544)	(57,641)
Accrued expenses and other current liabilities	33,995	26,933
Net cash provided by operating activities	37,220	53,846
Investing activities		
Acquisition of businesses, net of cash acquired	(9,381)	(1,244)
Purchase of property and equipment, net of sale proceeds	(14,687)	(14,407)
Other investments, net	133	76
Net cash used in investing activities	(23,935)	(15,575)
Financing activities		
Proceeds from revolving line of credit	658,720	596,642
Payments on revolving line of credit	(542,018)	(567,092)
Proceeds from asset-backed financing	121,600	—
Payments on asset-backed financing	(93,600)	—
Proceeds from long-term debt and other long-term liabilities	1,621	—
Payments on long-term debt and other long-term liabilities	—	(10)
Payments of deferred financing costs	(7)	(754)
Excess tax benefits from share-based compensation	4,141	4,367
Proceeds from stock issued under share-based compensation plans	8,090	19,040
Payments of cash dividends	(28,075)	(25,120)
Purchases of treasury stock	(135,155)	(53,027)
Net cash used in financing activities	(4,683)	(25,954)
Effect of exchange rate changes on cash and cash equivalents	(2,153)	(558)
Change in cash and cash equivalents	6,449	11,759
Cash and cash equivalents at beginning of period	8,006	12,463
Cash and cash equivalents at end of period	\$ 14,455	\$ 24,222

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.

On July 31, 2014, we completed the purchase of a 60% interest in Pool Systems Pty. Ltd. (PSL), an Australian company. We accounted for this acquisition using the acquisition method of accounting. The purchase 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 2013 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, 2014 are not necessarily indicative of the expected results for our fiscal year ending December 31, 2014.

Retained Deficit

We account for the retirement of treasury shares as a reduction of retained earnings (deficit). As of September 30, 2014, 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 \$814.3 million and cumulative dividends of \$265.4 million.

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 their effect is anti-dilutive.

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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,		September 30,	
	2014	2013	2014	2013
Net income	\$ 34,958	\$ 32,332	\$ 113,009	\$ 102,305
Less: net income attributable to noncontrolling interest	(122)	—	(122)	—
Net income attributable to Pool Corporation	\$ 34,836	\$ 32,332	\$ 112,887	\$ 102,305
Weighted average shares outstanding:				
Basic	43,756	46,380	44,563	46,475
Effect of dilutive securities:				
Stock options and employee stock purchase plan	1,108	1,218	1,167	1,245
Diluted	44,864	47,598	45,730	47,720
Earnings per share:				
Basic	\$ 0.80	\$ 0.70	\$ 2.53	\$ 2.20
Diluted	\$ 0.78	\$ 0.68	\$ 2.47	\$ 2.14
Anti-dilutive stock options excluded from diluted earnings per share computations	169	—	169	—

Note 3 – Acquisitions

In July 2014, we purchased a 60% controlling interest in PSL, a distributor of swimming pool and spa equipment, accessories and leisure products, with one sales center located in Brisbane, Australia. As part of this transaction, PSL acquired Niagara Pool Supplies (Niagara), a distributor of pool products, with two sales centers in New South Wales, Australia. In addition to the cash consideration paid, we recorded contingent consideration related to a potential future payout (based on PSL's fiscal 2015 earnings), which is included in Accrued expenses and other current liabilities on our Consolidated Balance Sheets.

In February 2014, we acquired certain distribution assets of Atlantic Chemical & Aquatics Inc., a regional swimming pool products distributor based in Nova Scotia with two sales center locations serving the Maritime Provinces of Canada. In March 2014, we acquired certain distribution assets of DFW Stone Supply, LLC, a distributor of natural stone and rock products and masonry supplies with two sales center locations in the Dallas, Texas metropolitan area.

We completed our preliminary acquisition accounting for these acquisitions, subject to adjustments in accordance with the terms of the purchase agreements during the respective one year measurement periods. These acquisitions did not have a material impact on our financial position or results of operations.

In March 2013, we acquired certain distribution assets of Swimming Pool Supply Center, Inc., a local swimming pool products distributor with one sales center location in Los Angeles, California. This sales center operates as a satellite location to more efficiently serve our west Los Angeles customers. In May 2013, we acquired certain distribution assets of B. Shapiro Supply, LLC, a swimming pool and hardscape products distributor with one sales center location in Warminster, Pennsylvania.

We completed our acquisition accounting for these acquisitions. These acquisitions 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 our recent acquisition.

Level 2

For determining the fair value of our interest rate swap contracts, we use significant other observable market data or assumptions (Level 2 inputs as defined in the accounting guidance) 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 have five interest rate swap contracts in place to reduce our exposure to fluctuations in interest rates on our unsecured syndicated senior credit facility (the Credit Facility). These swaps convert the variable interest rate to a fixed interest rate on borrowings under the Credit Facility. Each of these swap contracts terminates on October 19, 2016. The following table provides additional details related to each of these swap contracts:

Derivative	Effective Date	Notional Amount (in millions)	Fixed Interest Rate
Interest rate swap 1	November 21, 2011	\$25.0	1.185%
Interest rate swap 2	November 21, 2011	\$25.0	1.185%
Interest rate swap 3	December 21, 2011	\$50.0	1.100%
Interest rate swap 4	January 17, 2012	\$25.0	1.050%
Interest rate swap 5	January 19, 2012	\$25.0	0.990%

In May 2014, we entered into four forward-starting interest rate swap contracts to reduce our exposure to future fluctuations in interest rates on our Credit Facility. These swaps will convert the variable interest rate to a fixed interest rate on borrowings under the Credit Facility. Each of these forward starting swap contracts becomes effective on October 19, 2016 and terminates on September 20, 2018. The following table provides additional details related to each of these new swap contracts:

Derivative	Inception Date	Notional Amount (in millions)	Fixed Interest Rate
Forward-starting interest rate swap 1	May 8, 2014	\$25.0	2.520%
Forward-starting interest rate swap 2	May 14, 2014	\$50.0	2.450%
Forward-starting interest rate swap 3	May 19, 2014	\$50.0	2.339%
Forward-starting interest rate swap 4	May 28, 2014	\$25.0	2.256%

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 have designated these swaps as cash flow hedges and we record the changes in the estimated fair value of the swaps to Accumulated other comprehensive income (loss) on our Consolidated Balance Sheets. If our interest rate swaps became ineffective, we would immediately recognize the changes in the estimated fair value of our swaps in earnings. Since inception, we have not recognized any gains or losses on these swaps through income and there has been no effect on income from hedge ineffectiveness.

For our five interest rate swap contracts currently in effect, 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 income (loss) to Interest expense, net on the Consolidated Statements of Income. These amounts were not material in the first nine months of 2014 and 2013.

The table below presents the estimated fair value of our interest rate swap contracts and our forward-starting interest rate swap contracts (in thousands):

	Fair Value at	
	September 30,	
Level 2	2014	2013
Unrealized Gains on Interest Rate Swaps	\$ 196	\$—
Unrealized Losses on Interest Rate Swaps	\$(1,239)	\$(1,909)

We include unrealized losses in Accrued expenses and other current liabilities and unrealized gains in Prepaid expenses and other current assets on the Consolidated Balance Sheets.

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

Level 3

As of September 30, 2014, our Consolidated Balance Sheets reflect \$0.2 million in Accrued expenses and other current liabilities for contingent consideration related to a potential future payout for the PSL acquisition. In determining this estimate, we applied an income approach using a probability-weighted model of possible outcomes based on our estimates of fiscal 2015 earnings for PSL (Level 3 inputs as defined in the accounting guidance).

The carrying values of cash, receivables, accounts payable and accrued liabilities approximate fair value due to the short maturity of those instruments and the carrying value of long-term debt approximates fair value. Our determination of the estimated fair value of long-term debt reflects a discounted cash flow model using our estimates, primarily those related to assumptions for borrowing rates (Level 3 inputs as defined in the accounting guidance).

Note 5 – Debt

The table below presents the components of our debt at September 30, 2014 and September 30, 2013 (in thousands):

	September 30,	
	2014	2013
Variable rate debt		
Current portion:		
Australian Seasonal Credit Facility	\$ 2,618	\$—
Long-term portion:		
Revolving Credit Facility	311,120	260,432
Receivables Securitization Facility	80,000	—
Total debt	\$ 393,738	\$ 260,432

PSL utilizes the Australian Seasonal Credit Facility to supplement working capital needs during its peak season, which runs from July to March. The arrangement provides a borrowing capacity of A\$3.0 million, and any amounts outstanding must be repaid by April 1.

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.

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 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.

Note 6 – Redeemable Noncontrolling Interest

As discussed in Note 3 - Acquisitions, in July 2014, we purchased a controlling interest in PSL. Included in the transaction documents is a put/call option deed that grants us an option to purchase the shares held by the noncontrolling interest, and grants 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 is considered an equity contract and therefore a financial instrument under the accounting guidance. In applying the guidance for this transaction, we have determined that the financial instrument is embedded in the noncontrolling interest. As a public company, we are 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.

At the end of each period, we record the portion of comprehensive income or loss attributable to the noncontrolling interest to Redeemable noncontrolling interest to determine the carrying amount. We are required to compare the carrying amount to our estimated redemption value at the end of each reporting period. The redemption value is based on a multiple of a PSL earnings measure for a specified time period. To the extent that the estimated redemption value exceeds the carrying amount, we would record an adjustment to Redeemable noncontrolling interest. We did not record such an adjustment at September 30, 2014.

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

	September 30, 2014
Redeemable noncontrolling interest, beginning of period	\$—
Acquisition date value of noncontrolling interest	3,131
Net income attributable to noncontrolling interest	122
Other comprehensive loss attributable to noncontrolling interest	(109)
Redeemable noncontrolling interest, end of period	\$3,144

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 2013 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 future performance, statements of management's plans and objectives, future contracts, and 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 and other risks detailed in our 2013 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

We finished the third quarter with record results. Our sales benefited from the continuing demand for discretionary products that create and enhance outdoor living areas. Building materials, tile and lighting showed double-digit sales growth again this quarter. As we wrap up the 2014 season, our solid results reflect the depth of our product offerings backed by our knowledge and our ability to provide exceptional service - a critical factor for our customers.

Net sales for the quarter ended September 30, 2014 increased 6% compared to the third quarter of 2013, with base business sales up 5% for the period. Consistent with the first half of the year, replacement and remodel activity continued to drive sales growth.

Gross profit for the third quarter of 2014 increased 8% versus the same period in 2013. Gross profit as a percentage of net sales (gross margin) improved 50 basis points to 28.6% in the third quarter of 2014, reflecting our initiatives to spur margin improvements.

Selling and administrative expenses (operating expenses) increased 8% in the third quarter of 2014 compared to the same period in 2013, with base business operating expenses up 6% for the period. This increase includes higher performance-based incentive compensation expense in 2014 due to comparatively better results versus performance targets this year compared to last, greater employee insurance expense, increased freight costs and continued increases in infrastructure investments such as additional personnel and expenses related to equipment and technology to support sales growth.

Operating income for the quarter increased 10% compared to the same period in 2013. Operating income as a percentage of net sales (operating margin) was 9.5% for the third quarter of 2014 compared to 9.2% for the same period in 2013.

Net income attributable to Pool Corporation increased 8% to \$34.8 million in the third quarter of 2014 compared to the same period last year. Earnings per share increased by \$0.10, or 15%, to \$0.78 per diluted share for the three months ended September 30, 2014.

Financial Position and Liquidity

Total net receivables, including pledged receivables, increased 15% from September 30, 2013. Excluding recent acquisitions, total net receivables increased 12%, reflecting an extra day in our September billing cycle compared to last year, as well as third quarter 2014 sales growth. Our receivables quality remains high, with days sales outstanding (DSO), as calculated on a trailing twelve month basis, of 28.5 days at September 30, 2014 compared to 28.3 days at September 30, 2013. Our allowance for doubtful accounts balance was \$4.3 million at September 30, 2014 compared to \$4.5 million at September 30, 2013.

Net inventory levels increased 13% to \$414.3 million at September 30, 2014. Excluding recent acquisitions, net inventory levels increased 12% compared to September 30, 2013. This increase reflects greater levels of opportunistic buying in the third quarter, as well as differences in the timing of inventory receipts last year. The inventory reserve was \$8.3 million at September 30, 2014 and \$8.7 million at September 30, 2013. Our inventory turns, as calculated on a trailing twelve month basis, were 3.4 times at both September 30, 2014 and September 30, 2013.

Total debt outstanding of \$393.7 million at September 30, 2014 increased 51% compared to September 30, 2013 primarily to fund greater share repurchases in 2014 versus 2013 and also due to timing differences in the inventory purchase and payment cycle.

Current Trends and Outlook

For a detailed discussion of trends through 2013, see the Current Trends and Outlook section of Management's Discussion and Analysis included in Item 7 of our 2013 Annual Report on Form 10-K.

As we enter our seasonally slow fourth quarter, we remain on target with our earnings projections determined at the onset of the year. For 2014, we expect sales and gross profit growth rates in the mid- to upper-single digits and sales of refurbishment and replacement related products to continue to grow at higher rates than sales of maintenance and other non-discretionary products. We project slight gross margin improvement for the full year 2014 compared to 2013.

We expect moderate base business operating expense growth in the fourth quarter. Although we anticipate overall 2014 performance-based compensation expense will be higher than 2013, we believe fourth quarter 2014 performance-based compensation expense will be lower compared to the same period last year. This expectation is based on the seasonality of our earnings and last year's strong fourth quarter results relative to the rest of 2013. For the full year 2014, we project our effective income tax rate will approximate 38.5% to 39.0%. 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. The fourth quarter effective income tax rate is typically slightly above the full year rate.

We have tightened our 2014 earnings guidance to a range of \$2.38 to \$2.43 per diluted share from the \$2.35 to \$2.45 per diluted share guidance range provided at the beginning of the year. We expect cash provided by operations will be in line with net income for the full year 2014.

RESULTS OF OPERATIONS

As of September 30, 2014, we conducted operations through 329 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		Nine Months Ended		
	September 30,		September 30,		
	2014	2013	2014	2013	
Net sales	100.0	% 100.0	% 100.0	% 100.0	%
Cost of sales	71.4	71.9	71.3	71.5	
Gross profit	28.6	28.1	28.7	28.5	
Operating expenses	19.1	18.9	18.6	18.6	
Operating income	9.5	9.2	10.1	9.9	
Interest expense, net	0.3	0.3	0.3	0.3	
Income before income taxes and equity earnings (loss)	9.2	% 9.0	% 9.8	% 9.6	%

Note: Due to rounding, percentages may not add up to operating income or income before income taxes and equity earnings (loss).

We have included the results of operations from acquisitions in 2014 and 2013 in our consolidated results since the respective acquisition dates.

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Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

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 September 30,		Three Months Ended September 30,		Three Months Ended September 30,			
	2014	2013	2014	2013	2014	2013		
Net sales	\$ 607,469	\$ 577,731	\$ 8,067	\$ 426	\$ 615,536	\$ 578,157		
Gross profit	173,461	162,440	2,783	117	176,244	162,557		
Gross margin	28.6	% 28.1	% 34.5	% 27.5	% 28.6	% 28.1		%
Operating expenses	115,175	109,019	2,612	163	117,787	109,182		
Expenses as a % of net sales	19.0	% 18.9						