POOL CORP
Form 10-Q
October 28, 2016

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

FORM 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission File Number: 0-26640

POOL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	36-3943363
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer 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 x NO o

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 x NO o

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

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

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

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

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POOL CORPORATION
Consolidated Statements of Income
(Unaudited)
(In thousands, except per share data)

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

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

POOL CORPORATION
Consolidated Statements of Comprehensive Income
(Unaudited)
(In thousands)

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

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

POOL CORPORATION
Consolidated Balance Sheets
(In thousands, except share data)

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

(1) Derived from audited financial statements.
The accompanying Notes are an integral part of the Consolidated Financial Statements.

POOL CORPORATION
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

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

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

POOL CORPORATION
Notes to Consolidated Financial Statements
(Unaudited)
Note 1 – Summary of Significant Accounting Policies

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

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

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

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

Variable Interest Entity

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

Retained Deficit

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

New Accounting Pronouncements

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

Note 2 – Earnings Per Share

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

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

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

Note 3 – Acquisitions

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

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

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

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

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

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

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

Note 4 – Fair Value Measurements and Interest Rate Swaps

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

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

Level 2 Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability; or
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

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

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

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

Interest Rate Swaps

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

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

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

As of September 30, 2016, we had five interest rate swap contracts in effect that 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%

For the five interest rate swap contracts in effect at September 30, 2016, 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 to Interest and other non-operating expenses, net on the Consolidated Statements of Income. These amounts were not material in the first nine months of 2016 nor 2015.

We also have three forward-starting interest rate swap contracts in place that were amended in October 2015. These swaps were amended 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 following the October 19, 2016 termination date of the swap contracts described above. Concurrent with this amendment of these contracts, we de-designated the original hedge arrangements and designated the amended forward-starting interest rate swap contracts as cash flow hedges, which become effective on October 19, 2016 and terminate on November 20, 2019. In the fourth quarter of 2015, we recognized a benefit as a result of our determination of ineffectiveness for that period. In the first quarter of 2016, these forward-starting interest rate swaps were deemed effective, and the benefit previously recognized was reversed, resulting in $0.6 million in expense. This amount was recorded in Interest and other non-operating expenses, net on our Consolidated Statements of Income. There was no benefit or expense recognized in the second and third quarters of 2016 as these swaps continued to be effective for the periods. The following table provides additional details related to each of these amended swap contracts:

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

We are required to amortize the amounts related to the changes in the fair values of these swaps as of the de-designation date of the original forward-starting swap contracts. These unrealized losses, which are recorded in Accumulated other comprehensive loss and total $3.7 million, will be amortized over the effective period of the original forward-starting interest rate swap contracts from October 2016 to September 2018.

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. 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 new swap contract:

Derivative	Inception Date

		Notional Amount (in millions)	Fixed Interest Rate
Forward-starting interest rate swap 4	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.

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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, 2016, our Consolidated Balance Sheets reflected $0.2 million in Accrued expenses and other current liabilities and $0.7 million in Other long-term liabilities for contingent consideration related to future payouts for our acquisition of The Melton Corporation. In determining the estimate for contingent consideration, which is based on a percentage of gross profit for certain products, we applied a linear model using our best estimate of gross profit projections for fiscal years 2016 to 2020 (Level 3 inputs as defined in the accounting guidance). No adjustments to our original estimates of future payouts have been required since the acquisition date. We have determined that the contingent consideration liability was in a range of acceptable estimates as of September 30, 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, 2016, our Consolidated Balance Sheets also reflected close to $0.1 million in Accrued expenses and other current liabilities and $0.7 million in Other long-term liabilities for contingent consideration related to future payouts for our acquisition of Metro Irrigation Supply Company Ltd. This contingent consideration is based on a multiple of gross profit for fiscal years 2016 to 2020, with a maximum total payout of $1.0 million over this time period. We determined our estimate based on a methodology similar to that used for our contingent consideration liability described above.

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). In the third quarter of 2016, we recorded an additional $0.5 million fair value adjustment to the note receivable based on the results of our discounted cash flow model. 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 as of September 30, 2016 and September 30, 2015 (in thousands):

	September 30,	
	2016	2015
Variable rate debt		
Short-term borrowings	$—	$965
Current portion of long-term debt:		
Australian Seasonal Credit Facility	1,298	834
Short-term borrowings and current portion of long-term debt and other long-term liabilities	1,298	1,799

Long-term portion:		
Revolving Credit Facility	280,068	282,867
Receivables Securitization Facility	110,000	110,200
Less: financing costs, net	1,177	1,496
Long-term debt, net	388,891	391,571
Total debt	$390,189	$393,370

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 3-month Euro Interbank Offered Rate (EURIBOR), plus a fixed margin. The facility has a seasonal maximum borrowing capacity of €10.0 million. We are required to pay a commitment fee, which is based on the borrowing capacity schedule. We pay this fee annually, in advance.

PSL utilizes the Australian Seasonal Credit Facility, which provides a borrowing capacity of AU$3.0 million, to supplement working capital needs during its peak season from July to March.

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.

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 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, 2016.

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

	September 30, 2016
Redeemable noncontrolling interest, beginning of period	$ 2,665
Net loss attributable to noncontrolling interest	(309)
Other comprehensive income attributable to noncontrolling interest	111
Redeemable noncontrolling interest, end of period	$ 2,467

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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 2015 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 and other risks detailed in our 2015 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 experienced a solid third quarter with results that were slightly better than our expectations. Net sales for the third quarter of 2016 increased 7% to $691.4 million compared to $645.8 million in the third quarter of 2015, with base business sales up 5% for the period. Our sales continue to benefit from stronger consumer discretionary spending as evidenced by our increase in sales of pool construction materials and ancillary equipment and supplies, as consumers continue to invest in enhancing their outdoor living spaces.

Gross profit for the third quarter of 2016 increased 8% compared to the same period last year. Base business gross profit improved 6% over the third quarter of last year. Gross profit as a percentage of net sales (gross margin) increased 40 basis points to 28.9% compared to the third quarter of 2015, reflecting gains from supply chain management initiatives this year compared to last.

Selling and administrative expenses (operating expenses) increased 6% compared to the third quarter of 2015, with base business operating expenses up 3% over the comparable 2015 period. While the overall increase in operating expenses includes expenses from our recent acquisitions, the increase in base business operating expenses was primarily due to higher growth-driven labor and freight expenses.

Operating income for the third quarter increased 13% compared to the same period in 2015. Operating income as a percentage of net sales (operating margin) was 10.7% for the third quarter of 2016 compared to 10.1% in the third quarter of 2015.

Net income attributable to Pool Corporation increased 13% compared to the third quarter of 2015. Earnings per share increased to $1.03 per diluted share for the three months ended September 30, 2016 versus $0.90 per diluted share for the comparable period in 2015.

Financial Position and Liquidity

Total net receivables, including pledged receivables, increased 6% from September 30, 2015. Our allowance for doubtful accounts balance was $3.7 million at September 30, 2016 and $3.5 million at September 30, 2015. Net inventory levels grew 10% compared to levels at September 30, 2015. The inventory reserve was $8.1 million at September 30, 2016 and $8.3 million at September 30, 2015. Our inventory turns, as calculated on a trailing twelve month basis, were 3.6 times at September 30, 2016 and 3.4 times at September 30, 2015. Accrued expenses and other current liabilities at September 30, 2016 include $37.5 million in deferred third quarter estimated tax payments. This deferral was allowed for areas affected by severe storms and flooding in Louisiana, and the payments will be made in the fourth quarter of 2016.

Total debt outstanding at September 30, 2016 was $390.2 million, a $3.2 million, or 1% decrease compared to total debt at September 30, 2015.

Current Trends and Outlook

For a detailed discussion of trends through 2015, see the Current Trends and Outlook section of Management's Discussion and Analysis included in Item 7 of our 2015 Annual Report on Form 10-K.

As we move into our traditionally slower fourth quarter, we are mindful of the favorable weather conditions in the fourth quarter of 2015 that extended last year's pool season in certain seasonal markets. We also have one less selling day in the fourth quarter of 2016 compared to the fourth quarter of 2015. Considering this and our performance to date, we expect to achieve overall base business sales growth of 6% to 7% for the full year 2016, with low single digit sales growth in the fourth quarter. With the gains already realized this year, we expect that gross margin for 2016 will be 20 to 30 basis points better than gross margin for 2015.

For the full year, we expect our operating expense growth rate will be approximately half the rate of our gross profit growth, reflecting our expense discipline, inflationary increases and incremental costs to support our sales growth expectations.

We expect that our 2016 effective tax rate will be consistent with last year. 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. As a result of these factors, our total income tax provision may also fluctuate on a quarterly basis.

Factoring in all of the above variables, we updated our 2016 earnings guidance to a range of $3.40 to $3.46 per diluted share, from our previously disclosed range of $3.30 to $3.45 per diluted share. We expect cash provided by operations will exceed net income for the 2016 fiscal year. Through September 30, 2016, we have spent $115.3 million to purchase shares of our common stock on the open market. We anticipate that we may use approximately $150.0 million to $200.0 million in cash to fund share repurchases during the year.

RESULTS OF OPERATIONS
As of September 30, 2016, 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,	
	2016	2015	2016	2015
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	71.1	71.5	71.1	71.4
Gross profit	28.9	28.5	28.9	28.6
Operating expenses	18.1	18.4	17.3	17.8
Operating income	10.7	10.1	11.6	10.8
Interest and other non-operating expenses, net	0.4	0.4	0.5	0.3
Income before income taxes and equity earnings	10.3 %	9.8 %	11.1 %	10.5 %

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 acquisitions in 2016 and 2015 in our consolidated results since the respective acquisition dates.

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

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

(Unaudited)	Base Business		Excluded		Total	
(in thousands)	Three Months Ended		Three Months Ended		Three Months Ended	
	September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015
Net sales	$677,198	$645,779	$14,231	$ —	$691,429	$645,779
Gross profit	195,133	184,288	4,418	—	199,551	184,288
Gross margin	28.8 %	28.5 %	31.0 %	—%	28.9 %	28.5 %
Operating expenses	122,436	118,776	2,949	—	125,385	118,776
Expenses as a % of net sales	18.1 %	18.4 %	20.7 %	—%	18.1 %	18.4 %
Operating income (loss)	72,697	65,512	1,469	—	74,166	65,512
Operating margin	10.7 %	10.1 %	10.3 %	—%	10.7 %	10.1 %

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

Acquired [1]	Acquisition Date	Net Sales Centers Acquired	Periods Excluded
Metro Irrigation Supply Company Ltd.	April 2016	8	July - September 2016
The Melton Corporation	November 2015	2	July - September 2016
Seaboard Industries, Inc.	October 2015	3	July - September 2016

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

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 2016:

December 31, 2015	336
Acquired locations	8
New locations	4
Consolidated locations	(2)
September 30, 2016	346

Net Sales

(in millions)	Three Months Ended September 30, 2016	2015	Change	
Net sales	$691.4	$645.8	$45.6	7%

Net sales for the third quarter of 2016 increased 7% compared to the third quarter of 2015, with base business sales up 5% for the period. The following factors impacted our sales growth (listed in order of estimated magnitude):

- continued improvement in consumer discretionary expenditures, including some market recovery in remodeling and replacement activity as consumers invest in enhancing outdoor living spaces (see discussion below);
- market share growth, particularly in building materials and commercial product categories (see discussion below);
- increased chemical sales, our largest product category, up 5% from the same period of last year; and
- inflationary (estimated at approximately 1%) product cost increases.

Sales of building materials and tile grew by 8% compared to the third quarter of 2015. Sales of equipment such as heaters, pumps, filters, chlorinators and lights, increased by 5% compared to the third quarter of 2015. The quarter to date sales growth rates in each of these categories are lower than their year to date growth rates primarily due to weather drivers in Texas. In the third quarter of last year, our sales in Texas benefited as customers aimed to catch up on projects following the heavy rains and flooding in the second quarter of 2015. The extreme rainfall experienced in Texas was not as prevalent in the second quarter of 2016, ultimately resulting in less of a backlog to fill in the third quarter of 2016.

Commercial product sales increased 13% compared to the third quarter of 2015. While this category represented only 3% of our consolidated net sales for the quarter, this growth reflects the increase in resources that we have assigned to this category.

Gross Profit

(in millions)	Three Months Ended September 30, 2016	2015	Change	
Gross profit	$199.6	$184.3	$15.3	8%
Gross margin	28.9 %	28.5 %		

Gross margin for the third quarter of 2016 increased 40 basis points compared to the third quarter of 2015, largely reflecting gains from supply chain management initiatives this year.

Operating Expenses

(in millions)	Three Months Ended September 30, 2016	2015	Change	
Operating expenses	$125.4	$118.8	$6.6	6%
Operating expenses as a % of net sales	18.1 %	18.4 %		

Operating expenses increased 6% in the third quarter of 2016 compared to the third quarter of 2015, with base business operating expenses up 3% compared to the same period last year. While the overall increase in operating expenses includes expenses from our recent acquisitions, the increase in base business operating expenses was primarily due to higher growth-driven labor and freight expenses. Our operating expenses also include a $0.6 million goodwill impairment charge related to a previously disclosed at-risk reporting unit in Quebec, Canada. We have been monitoring this location’s results, which came in below expectations at the end of the 2016 pool season. As of September 30, 2016, the remaining goodwill balance for this reporting unit is $1.7 million.

Interest and Other Non-operating Expenses, Net

Interest and other non-operating expenses, net increased $0.5 million compared to the third quarter of 2015. The primary component is interest expense on our borrowings. Our weighted average effective interest rate increased to 2.0% for the third quarter of 2016 from 1.8% for the third quarter of 2015 on higher average outstanding debt of $426.7 million versus $403.7 million for the respective periods.

Income Taxes

Our effective income tax rate of 37.7% for the three months ended September 30, 2016 was comparable with our 37.6% effective income tax rate for the three months ended September 30, 2015. Our third quarter effective income tax rate is typically lower compared to other quarters. This is primarily due to the impact of the timing of our accounting for uncertain tax positions, including the expiration of statutes of limitations.

Net Income and Earnings Per Share

Net income attributable to Pool Corporation for the third quarter of 2016 increased 13% to $44.5 million compared to the third quarter of 2015. Earnings per diluted share increased to $1.03 for the third quarter of 2016 versus $0.90 per diluted share for the comparable period in 2015.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015

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

(Unaudited)	Base Business		Excluded		Total	
(in thousands)	Nine Months Ended		Nine Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015
Net sales	$2,089,745	$1,947,386	$35,823	$678	$2,125,568	$1,948,064
Gross profit	602,623	557,174	10,687	175	613,310	