POOL CORP
Form 10-Q
April 30, 2010

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 March 31, 2010

or

o 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<br>(State or other jurisdiction of<br>incorporation or organization) | 36-3943363<br>(I.R.S. Employer<br>Identification No.) |
| 109 Northpark Boulevard,<br>Covington, Louisiana<br>(Address of principal executive offices) | 70433-5001<br>(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 ¨

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 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 x | Accelerated filer ¨ |
| 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 x

At April 23, 2010, there were 49,472,216 outstanding shares of the registrant's common stock, $.001 par value per share.

POOL CORPORATION
Form 10-Q
For the Quarter Ended March 31, 2010

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# PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Net sales | $ 269,833 | $ 276,626 |
| Cost of sales | 193,541 | 195,433 |
| Gross profit | 76,292 | 81,193 |
| Selling and administrative expenses | 84,180 | 84,839 |
| Operating loss | (7,888) | (3,646) |
| Interest expense, net | 2,354 | 3,327 |
| Loss before income tax benefit and equity earnings (loss) | (10,242) | (6,973) |
| Income tax benefit | (4,025) | (2,740) |
| Equity earnings (loss) in unconsolidated investments, net | 106 | (2,003) |
| Net loss | $ (6,111) | $ (6,236) |
| | | |
| Loss per share: | | |
| Basic | $ (0.12) | $ (0.13) |
| Diluted | $ (0.12) | $ (0.13) |
| Weighted average shares outstanding: | | |
| Basic | 49,194 | 48,287 |
| Diluted | 49,194 | 48,287 |
| | | |
| Cash dividends declared per common share | $ 0.13 | $ 0.13 |

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

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

| | March 31, 2010 (Unaudited) | March 31, 2009 (Unaudited) | December 31, 2009 (1) |
|---|---|---|---|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 11,494 | $ 13,103 | $ 15,843 |
| Receivables, net | 157,568 | 20,373 | 96,364 |
| Receivables pledged under receivables facility | — | 139,945 | — |
| Product inventories, net | 382,380 | 397,863 | 355,528 |
| Prepaid expenses and other current assets | 13,513 | 7,973 | 12,901 |
| Deferred income taxes | 10,681 | 11,908 | 10,681 |
| Total current assets | 575,636 | 591,165 | 491,317 |
| | | | |
| Property and equipment, net | 32,206 | 34,677 | 31,432 |
| Goodwill | 176,923 | 169,936 | 176,923 |
| Other intangible assets, net | 13,454 | 13,035 | 13,917 |
| Equity interest investments | 1,087 | 27,804 | 1,006 |
| Other assets, net | 28,556 | 27,158 | 28,504 |
| Total assets | $ 827,862 | $ 863,775 | $ 743,099 |
| | | | |
| Liabilities and stockholders' equity | | | |
| Current liabilities: | | | |
| Accounts payable | $ 251,590 | $ 201,300 | $ 178,391 |
| Accrued expenses and other current liabilities | 25,429 | 24,911 | 33,886 |
| Short-term financing | — | 8,000 | — |
| Current portion of long-term debt and other long-term liabilities | 36,223 | 16,613 | 48,236 |
| Total current liabilities | 313,242 | 250,824 | 260,513 |
| | | | |
| Deferred income taxes | 21,979 | 19,014 | 21,920 |
| Long-term debt | 242,150 | 356,721 | 200,700 |
| Other long-term liabilities | 7,646 | 5,736 | 7,779 |
| Total liabilities | 585,017 | 632,295 | 490,912 |
| | | | |
| Stockholders' equity: | | | |
| Common stock, $.001 par value; 100,000,000 shares authorized; 49,439,423, 48,358,089 and 48,991,729 shares issued and outstanding at March 31, 2010, March 31, 2009 and | | | |

| | | | |
|---|---|---|---|
| December 31, 2009, respectively | 49 | 48 | 49 |
| Additional paid-in capital | 207,803 | 192,261 | 202,784 |
| Retained earnings | 33,066 | 41,832 | 47,128 |
| Accumulated other comprehensive income (loss) | 1,927 | (2,661) | 2,226 |
| Total stockholders’ equity | 242,845 | 231,480 | 252,187 |
| Total liabilities and stockholders’ equity | $ 827,862 | $ 863,775 | $ 743,099 |

(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)

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| Operating activities | | |
| Net loss | $ (6,111) | $ (6,236) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 2,224 | 2,209 |
| Amortization | 567 | 662 |
| Share-based compensation | 1,871 | 1,321 |
| Excess tax benefits from share-based compensation | (795) | (275) |
| Equity (earnings) loss in unconsolidated investments | (106) | 3,353 |
| Other | (2,329) | (2,458) |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | |
| Receivables | (59,755) | (44,221) |
| Product inventories | (26,576) | 7,510 |
| Accounts payable | 73,244 | 27,600 |
| Other current assets and liabilities | (7,518) | (35,432) |
| Net cash used in operating activities | (25,284) | (45,967) |
| | | |
| Investing activities | | |
| Purchase of property and equipment, net of sale proceeds | (3,133) | (3,881) |
| Net cash used in investing activities | (3,133) | (3,881) |
| | | |
| Financing activities | | |
| Proceeds from revolving line of credit | 99,050 | 87,121 |
| Payments on revolving line of credit | (57,600) | (19,400) |
| Proceeds from asset-backed financing | — | 13,000 |
| Payments on asset-backed financing | — | (25,792) |
| Payments on long-term debt and other long-term liabilities | (12,043) | (1,536) |
| Payments of deferred financing costs | (145) | (188) |
| Excess tax benefits from share-based compensation | 795 | 275 |
| Proceeds from stock issued under share-based compensation plans | 2,353 | 1,000 |
| Payments of cash dividends | (6,418) | (6,279) |
| Purchases of treasury stock | (1,533) | (59) |
| Net cash provided by financing activities | 24,459 | 48,142 |
| Effect of exchange rate changes on cash | (391) | (953) |
| Change in cash and cash equivalents | (4,349) | (2,659) |

| | | |
|---|---|---|
| Cash and cash equivalents at beginning of period | 15,843 | 15,762 |
| Cash and cash equivalents at end of period | $ 11,494 | $ 13,103 |

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 POOL, 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, certain footnotes and other financial information required by GAAP for complete financial statements have been condensed or omitted. The Consolidated Financial Statements include all normal and recurring adjustments that are necessary for a fair presentation of our financial position and operating results including the elimination of all significant intercompany accounts and transactions among our wholly owned subsidiaries.

A description of our significant accounting policies is included in our 2009 Annual Report on Form 10-K/A. The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and accompanying notes in our Annual Report. The results for the three month period ended March 31, 2010 are not necessarily indicative of the results to be expected for the twelve months ending December 31, 2010.

### Equity Method Investments

Prior to January 2010, we held a 38% equity investment in Latham Acquisition Corporation (LAC), which we accounted for using the equity method of accounting. In December 2009, LAC filed for bankruptcy. LAC's Plan of Reorganization was approved by the United States Bankruptcy Court for the District of Delaware in January 2010, allowing it to emerge from bankruptcy. As of the date of the approval, we no longer have an equity interest in LAC and did not recognize any impact related to LAC's first quarter 2010 results.

## Note 2 – Loss Per Share

We calculate basic earnings (loss) per share (EPS) by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted EPS includes the dilutive effects of stock option awards.

Since we reported a net loss for both the first quarter of 2010 and 2009, there is no difference between the basic and diluted weighted average shares outstanding for these periods. Potentially dilutive shares are excluded from the computation if their effect is anti-dilutive, meaning that the loss per share would decrease. For informational purposes, the table below presents the amounts we have excluded from the computation of diluted weighted average shares outstanding (in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| Weighted average common shares outstanding: | | |
| Basic | 49,194 | 48,287 |
| Effect of dilutive securities: | | |
| Stock options | 611 | 329 |
| Employee stock purchase plan | 3 | 2 |

| | | |
|---|---|---|
| Diluted | 49,808 | 48,618 |

The weighted average diluted shares outstanding in this computation also exclude stock options to purchase 2,039,050 shares at March 31, 2010 and 2,877,610 shares at March 31, 2009, which are considered anti-dilutive because the exercise prices for these options are higher than our common stock’s average market price.

Note 3 – Comprehensive Loss

Comprehensive loss includes net loss, foreign currency translation adjustments and the unrealized gain or loss on interest rate swaps. The table below presents comprehensive loss (in thousands):

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Comprehensive loss | $ (6,410) | $ (6,511) |

The table below presents the components of and changes in Accumulated other comprehensive income (loss) as of and for the three month period ended March 31, 2010 (in thousands):

| | Foreign Currency Translation | Unrealized Gain (Loss) on Interest Rate Swaps (1) | Total |
|---|---|---|---|
| Balance at December 31, 2009 | $ 5,255 | $ (3,029) | $ 2,226 |
| Net change | (391) | 92 | (299) |
| Balance at March 31, 2010 | $ 4,864 | $ (2,937) | $ 1,927 |

(1) Amounts are shown net of tax.

Note 4 – Debt

On March 1, 2010, we amended certain provisions in our unsecured syndicated senior credit facility (the Credit Facility) to increase the dividend limitation in 2010 from 50% to 55% of our 2009 Net Income (as defined in the Credit Facility agreement). All other provisions of our Credit Facility remain the same.

Note 5 – Fair Value Measurements and Interest Rate Swaps

Accounting Standards Codification 820, Fair Value Measurements and Disclosures, provides a framework for measuring fair value and establishes a fair value hierarchy that prioritizes the inputs used to measure fair value, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs), the next priority to observable market based inputs or unobservable inputs that are corroborated by market data (Level 2 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

In measuring the fair value of our assets and liabilities, we use significant other observable market data or assumptions (Level 2 inputs) that we believe market participants would use in pricing an asset or liability, including assumptions about risk when appropriate. Our assets and liabilities that are measured at fair value on a recurring basis include the unrealized gain or loss on our interest rate swaps.

We have three interest rate swap agreements currently in effect that reduce our exposure to fluctuations in interest rates on our Floating Rate Senior Notes (the Notes), our variable rate Term Loan under our Credit Facility and our

$240.0 million five-year revolving credit facility (the Revolver), which is part of our Credit Facility.

We have an interest rate swap agreement that converts the variable interest rate on the Notes to a fixed rate of 5.088% on the initial notional amount of $100.0 million, which decreased to a notional amount of $50.0 million in February 2010. This swap agreement terminates on February 12, 2012.

We have an interest rate swap agreement that converts the variable interest rate on the Term Loan to a fixed rate of 2.4% on the initial notional amount, which decreases as payments are made on the Term Loan until maturity on December 20, 2010.

Effective January 27, 2010, the interest rate swap agreement on our Revolver converts the Revolver's variable interest rate to a fixed rate of 1.725% on a notional amount of $50.0 million. This swap agreement terminates on January 27, 2012.

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 fair value of the swaps to Accumulated other comprehensive income (loss). 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. The table below presents the fair value of our swap agreements as of March 31, 2010 (in thousands):

| Balance Sheet Line Item | Unrealized Losses |
|---|---|
| Accrued expenses and other current liabilities | $ (4,838) |

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.

As discussed in Note 1 to the Consolidated Financial Statements in our 2009 Annual Report on Form 10-K/A, the carrying amount of long-term debt approximates fair value as it bears interest at variable rates.

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 2009 Annual Report on Form 10-K/A. For a discussion of our base business calculations, see page 10 under the RESULTS OF OPERATIONS section.

OVERVIEW

Financial Results

March is the official start of the pool season and we continue to see moderating sales declines as evidenced by a 5% decrease in base business sales in the first quarter of 2010 versus double digit base business sales declines for each quarter in 2009. More significantly, we realized flat base business sales in March excluding the benefit of one extra selling day compared to March 2009.

Net sales for the seasonally slow first quarter decreased approximately 3%, with base business sales down 5% due to higher sales in the first quarter of 2009 for new drains and related safety products driven by regulatory changes, unfavorable weather conditions during the first two months of 2010 and continued weakness in irrigation construction markets.

Gross profit as a percentage of net sales (gross margin) declined 110 basis points to 28.3% in the first quarter of 2010 due to the competitive pricing environment and the favorable impact to gross margin in the first quarter of 2009 that resulted from our volume of inventory purchases ahead of vendor price increases in the second half of 2008.

Selling and administrative expenses (operating expenses) decreased 1% in the first quarter of 2010 compared to the same period in 2009. Base business operating expenses decreased 3% compared to the first quarter of 2009 due primarily to the benefit of cost measures implemented during 2009.

Operating loss was $7.9 million in the first quarter of 2010 compared to an operating loss of $3.6 million in the same period in 2009. Interest expense decreased 29% compared to the first quarter of 2009 due to a $99.5 million decrease in average debt levels. We no longer have an equity interest in Latham Acquisition Corporation (LAC) and we did not recognize any impact related to LAC's first quarter 2010 results. In the first quarter of 2009, Equity loss in unconsolidated investments, net included $2.1 million related to LAC.

Loss per share for the first quarter of 2010 was $0.12 per diluted share on a net loss of $6.1 million, compared to a loss of $0.13 per diluted share on a net loss of $6.2 million in the same period in 2009.

Financial Position and Liquidity

Total net receivables decreased 2% to $157.6 million at March 31, 2010 from $160.3 million at March 31, 2009 due primarily to the decline in sales. Our allowance for doubtful accounts balance was approximately $10.0 million at March 31, 2010, a decrease of $3.4 million compared to March 31, 2009. The allowance for doubtful accounts has decreased approximately $1.4 million from December 31, 2009 to March 31, 2010. Days sales outstanding (DSO) decreased between periods to 34.2 days at March 31, 2010 compared to 36.3 days at March 31, 2009.

Our inventory levels decreased 4% to $382.4 million as of March 31, 2010 compared to $397.9 million as of March 31, 2009. Excluding inventory related to our October 2009 acquisition of General Pool & Spa Supply (GPS), inventories were down approximately 6% reflecting our focus on effective ordering and stock management. Our inventory turns, as calculated on a trailing twelve month basis, have remained flat at 3.1 times for both

March 31, 2010 and March 31, 2009.

Total debt outstanding was $278.2 million at March 31, 2010, a decrease of $103.0 million compared to March 31, 2009.

Current Trends

Adverse economic trends have significantly impacted our industry. These trends include a slowdown in the domestic housing market, with lower housing turnover, sharp drops in new home construction, home value deflation in many markets and a significant tightening of consumer and commercial credit. Additionally, general economic conditions have been weak, including declines in Gross Domestic Product (GDP) during the first nine months of 2009 and high unemployment rates. Some of the factors that help mitigate the impact of these negative trends on our business include the following:

- the majority of our business is driven by the ongoing maintenance and repair of existing pools and landscaped areas, with approximately 10% of our sales and gross profits tied to new pool or irrigation construction in 2009 (as our sales related to new construction activity have declined between 2006 and 2009, the proportion of our net sales represented by maintenance, repair and replacement (MRR) products has increased from over 60% to approximately 90%); and
- we believe our service-oriented model, and the investments in our business we are able to make given our financial strength, help us gain market share.

Despite these mitigating factors, the negative trends noted above have significantly impacted a number of our key markets, including California, Florida and Arizona, with a more recent adverse impact in Texas and other states. We estimate that these trends resulted in the following decreases in new pool construction in the United States since peaking in 2005 at approximately 210,000 new units:

| | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|
| Estimated new units | 45,000 | 90,000 | 150,000 | 200,000 |
| Unit decrease | (45,000) | (60,000) | (50,000) | (10,000) |
| % change from prior year units | (50)% | (40)% | (25)% | (5)% |

Since these trends worsened from 2006 through 2009, they had a more pronounced impact on our results in 2008 and 2009. However, as evidenced by moderating base business sales declines throughout 2009 in Florida, California and Arizona (including month over month sales growth in some markets and essentially flat fourth quarter sales in Florida compared to the same periods in 2008), we believe these trends have leveled off in certain major pool markets first impacted by the housing market downturn. Our first quarter base business sales results (including flat March 2010 base business sales overall compared to March 2009) also provide indications that these trends are moderating across most other markets.

Outlook

We have seen positive signs that indicate the first quarter of 2010 will likely mark the end of a three year downturn in our industry. The improving sales trends in the first quarter of 2010 have continued, as sales in April are trending up compared to April 2009. While we have increasing confidence in realizing positive sales comparisons to 2009 in the second quarter and balance of 2010, we expect continued pressure on gross margins given the competitive pricing environment. We continue to drive targeted expense reductions, although the rate of these decreases should continue to moderate throughout 2010 as we lap more of the impact of cost measures implemented in 2009.

We believe our initial 2010 earnings guidance of $1.00 to $1.15 per diluted share continues to be reasonable. The lower end of this range assumes earnings results consistent with fiscal 2009, but includes the comparative benefits from lower expected interest expense, the projected accretive impact of the GPS acquisition of approximately $0.02

per diluted share and the fact that there will be no impact from LAC since we no longer have an equity interest in LAC as of January 2010.

Our goal is for cash provided by operations to exceed net income for fiscal 2010. However, cash provided by operations will be comparatively lower than 2009 because we will not realize the same level of improvements from our ongoing working capital management initiatives.

The forward-looking statements in this Outlook section are subject to significant risks and uncertainties, including changes in the economy and the housing market, the sensitivity of our business to weather conditions, our ability to maintain favorable relationships with suppliers and manufacturers, competition from other leisure product alternatives and mass merchants, and other risks detailed in Part II - Item 1A “Risk Factors” and our “Cautionary Statement for Purpose of the ‘Safe Harbor’ Provisions of the Private Securities Litigation Reform Act of 1995”.

RESULTS OF OPERATIONS

As of March 31, 2010, we conducted operations through 288 sales centers in North America and Europe.

The following table presents information derived from the Consolidated Statements of Income (Loss) expressed as a percentage of net sales.

Three Months Ended