

POOL CORP
Form 10-Q
October 30, 2018

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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 ☒ No ☐

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

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

Non-accelerated filer ☐ Smaller reporting company ☐

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Emerging growth company ☐

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of October 25, 2018, there were 40,263,296 shares of common stock outstanding.

POOL CORPORATION

Form 10-Q

For the Quarter Ended September 30, 2018

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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,	
	2018	2017	2018	2017
Net sales	\$811,311	\$743,401	\$2,455,015	\$2,278,005
Cost of sales	576,308	526,795	1,745,283	1,618,114
Gross profit	235,003	216,606	709,732	659,891
Selling and administrative expenses	142,666	134,678	421,812	392,779
Operating income	92,337	81,928	287,920	267,112
Interest and other non-operating expenses, net	4,931	4,009	14,449	11,608
Income before income taxes and equity earnings	87,406	77,919	273,471	255,504
Income tax provision	18,206	29,179	55,989	89,951
Equity earnings in unconsolidated investments, net	61	43	167	121
Net income	69,261	48,783	217,649	165,674
Net loss attributable to noncontrolling interest	—	—	—	294
Net income attributable to Pool Corporation	\$69,261	\$48,783	\$217,649	\$165,968
Earnings per share:				
Basic	\$1.71	\$1.20	\$5.39	\$4.04
Diluted	\$1.66	\$1.16	\$5.20	\$3.89
Weighted average shares outstanding:				
Basic	40,422	40,659	40,416	41,065
Diluted	41,797	42,207	41,831	42,691
Cash dividends declared per common share	\$0.45	\$0.37	\$1.27	\$1.05

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,	
	2018	2017	2018	2017
Net income	\$69,261	\$48,783	\$217,649	\$165,674
Other comprehensive income (loss):				
Foreign currency translation adjustments	690	1,842	(2,188)	) 6,432
Change in unrealized gains and losses on interest rate swaps, net of change in taxes of \$(177), \$(181), \$(636) and \$(432)	530	283	1,908	675
Total other comprehensive income (loss)	1,220	2,125	(280)	) 7,107
Comprehensive income	70,481	50,908	217,369	172,781
Comprehensive loss attributable to noncontrolling interest	—	—	—	74
Comprehensive income attributable to Pool Corporation	\$70,481	\$50,908	\$217,369	\$172,855

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

POOL CORPORATION

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2018 (Unaudited)	September 30, 2017 (Unaudited)	December 31, 2017 ⁽¹⁾
Assets			
Current assets:			
Cash and cash equivalents	\$35,693	\$36,398	\$29,940
Receivables, net	90,775	90,142	76,597
Receivables pledged under receivables facility	196,998	172,654	119,668
Product inventories, net	609,983	484,287	536,474
Prepaid expenses and other current assets	19,457	14,832	19,569
Total current assets	952,906	798,313	782,248
Property and equipment, net	109,942	103,880	100,939
Goodwill	189,029	189,024	189,435
Other intangible assets, net	12,305	13,206	13,223
Equity interest investments	1,163	1,168	1,127
Other assets	18,413	16,333	14,090
Total assets	\$1,283,758	\$1,121,924	\$1,101,062
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	\$204,706	\$209,062	\$245,249
Accrued expenses and other current liabilities	75,639	87,887	65,482
Short-term borrowings and current portion of long-term debt	9,343	8,609	10,835
Total current liabilities	289,688	305,558	321,566
Deferred income taxes	24,802	27,244	24,585
Long-term debt, net	571,360	555,964	508,815
Other long-term liabilities	25,170	22,614	22,950
Total liabilities	911,020	911,380	877,916
Stockholders' equity:			
Common stock, \$0.001 par value; 100,000,000 shares authorized; 40,479,584, 40,122,935 and 40,212,477 shares issued and outstanding at September 30, 2018, September 30, 2017 and December 31, 2017, respectively	40	40	40
Additional paid-in capital	449,276	420,946	426,750
Retained deficit	(68,943)	(202,693)	(196,316)
Accumulated other comprehensive loss	(7,635)	(7,749)	(7,328)
Total stockholders' equity	372,738	210,544	223,146
Total liabilities and stockholders' equity	\$1,283,758	\$1,121,924	\$1,101,062

⁽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,	
	2018	2017
Operating activities		
Net income	\$217,649	\$165,674
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	19,499	17,947
Amortization	1,408	1,132
Share-based compensation	9,793	9,496
Equity earnings in unconsolidated investments, net	(167)	(121)
Other	3,584	1,074
Changes in operating assets and liabilities, net of effects of acquisitions:		
Receivables	(93,911)	(90,204)
Product inventories	(80,142)	9,057
Prepaid expenses and other assets	143	(1,523)
Accounts payable	(40,143)	(27,328)
Accrued expenses and other current liabilities	13,547	26,816
Net cash provided by operating activities	51,260	112,020
Investing activities		
Acquisition of businesses, net of cash acquired	(578)	(6,879)
Purchases of property and equipment, net of sale proceeds	(27,976)	(37,709)
Other investments, net	—	4
Net cash used in investing activities	(28,554)	(44,584)
Financing activities		
Proceeds from revolving line of credit	820,967	918,338
Payments on revolving line of credit	(813,996)	(857,609)
Proceeds from asset-backed financing	193,400	156,600
Payments on asset-backed financing	(138,400)	(97,800)
Proceeds from short-term borrowings and current portion of long-term debt	16,118	25,001
Payments on short-term borrowings and current portion of long-term debt	(17,610)	(17,497)
Payments of deferred and contingent acquisition consideration	(265)	(199)
Payments of deferred financing costs	(8)	(909)
Purchase of redeemable noncontrolling interest	—	(2,573)
Proceeds from stock issued under share-based compensation plans	12,732	8,647
Payments of cash dividends	(51,371)	(43,165)
Purchases of treasury stock	(38,906)	(141,580)
Net cash used in financing activities	(17,339)	(52,746)
Effect of exchange rate changes on cash and cash equivalents	386	(248)
Change in cash and cash equivalents	5,753	14,442
Cash and cash equivalents at beginning of period	29,940	21,956
Cash and cash equivalents at end of period	\$35,693	\$36,398

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.

All of our subsidiaries are wholly owned. From July 31, 2014 to June 29, 2017, we owned a 60% interest in Pool Systems Pty. Ltd. (PSL), an Australian company. Our ownership percentage constituted a controlling interest in the acquired company, which required us to consolidate PSL's financial position and results of operations from the date of acquisition. On June 29, 2017, we purchased the remaining 40% interest in PSL. Thus, we have continued to consolidate PSL, but there is no longer a separate noncontrolling interest reported on our Consolidated Statements of Income, nor Redeemable noncontrolling interest reported on our Consolidated Balance Sheets.

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 2017 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 2017 Annual Report on Form 10-K. The results for our three and nine month periods ended September 30, 2018 are not necessarily indicative of the expected results for our fiscal year ending December 31, 2018.

Newly Adopted Accounting Pronouncements

On January 1, 2018, we adopted Accounting Standards Update (ASU) 2014-09, Revenue - Revenue from Contracts with Customers, and all the related amendments, which are also codified into Accounting Standards Codification (ASC) 606. We elected to adopt this guidance using the modified retrospective method. The adoption of this standard did not have a material impact on our financial position or results of operations. We did not restate prior period information for the effects of the new standard, nor did we adjust the opening balance of our retained deficit to account for the implementation of the new requirements of this standard. We do not expect the adoption of this guidance to have a material effect on our results of operations in future periods.

Under the new standard, we recognize a sale when a customer obtains control of the product, and we record the amount that reflects the consideration we expect to receive in exchange for such product. As under the previous accounting guidance, we continue to recognize a sale when a customer picks up product at any sales center, when we deliver product to their premises or job sites via our trucks or when we present the product to a third-party carrier. For bill and hold sales, we determine when the customer obtains control of the product on a case-by-case basis to determine the amount of revenue to defer each period.

Our adoption of this guidance also resulted in balance sheet reclassifications for recording our estimate of customer returns. ASC 606 requires the recognition of a current liability for the gross amount of estimated returns and a current asset for the cost of the related products. This change did not have a material impact on our Consolidated Balance Sheet as of September 30, 2018.

On January 1, 2018, we adopted ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments. The new guidance specifies how cash flows should be classified for debt prepayment or extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds for the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance, distributions from equity method investees and beneficial interests in securitization transactions. Our adoption of ASU 2016-15 had no impact on our statement of cash flows as our previous classifications related to contingent consideration payments and distributions from equity method investees is consistent with the requirements of ASU 2016-15.

Revenue Recognition

We consider our distribution of products to represent one reportable revenue stream. Our products are similar in nature, and our revenue recognition policy is the same across our distribution networks. Our customers share similar characteristics and purchase products across all categories. We recognize revenue when our customers take control of our products. Customers may obtain our products by picking them up at any sales center location or through delivery to their premises or job sites by our trucks or third-party carriers. For customer pick-ups or deliveries by our trucks, control passes when our customers receive our products. For third-party deliveries, control passes when we present our products to the third-party carriers. We include shipping and handling fees billed to customers as freight out income within net sales.

We measure revenue as the amount of consideration we expect to receive in exchange for transferring our products. Consideration may vary due to volume incentives and expected customer returns. We offer volume incentives to some of our customers and account for these incentives as a reduction of sales. We estimate the amount of volume incentives earned based on our estimate of cumulative sales for the fiscal year relative to our customers' progress toward achieving minimum purchase requirements. We record customer returns, including those associated with customer early buy programs, as a reduction of sales. Based on available information related to our customers' returns, we record an allowance for estimated returns, which historically has not been material. We regularly review our marketing programs, coupons and customary business practices to determine if any variable consideration exists under ASC 606. Other items that we record as reductions to sales include cash discounts, pricing adjustments and credit card fees related to customer payments.

The majority of our sales transactions do not contain additional performance obligations after delivery; therefore, we do not have multiple performance obligations for which to allocate the transaction price. We elected to continue to recognize shipping and handling costs associated with outbound freight in selling and administrative expenses.

We report sales net of tax amounts that we collect from our customers and remit to governmental authorities. These tax amounts may include, but are not limited to, sales, use, value-added and some excise taxes.

Income Taxes

Both the Tax Cuts and Jobs Act (the Act), enacted by Congress in December 2017, and ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which we adopted on January 1, 2017, impacted our provision for income taxes by substantially reducing our income tax rate in the first nine months of 2018 compared to the first nine months of 2017.

As of September 30, 2018, we have not completed our accounting for all of the tax effects of the Act. We filed our federal income tax return in the third quarter of 2018, and our return to provision adjustment, which addresses the provisional tax benefit we recorded under Staff Accounting Bulletin (SAB) 118 at December 31, 2017, was not material. We have considered the impact of the statutory changes from the Act on our estimated effective tax rate for 2018, including reasonable estimates of those provisions effective for the 2018 tax year. The Act also created a new requirement that certain income earned by foreign subsidiaries, global intangible low-taxed income (GILTI), be included in the gross income of their U.S. shareholder. Entities may make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or recognize such taxes as a current-period expense when incurred. We elected to treat the tax effect of GILTI as a current-period expense when incurred.

We reduce federal and state income taxes payable by the tax benefits associated with the exercise of nonqualified stock options and the lapse of restrictions on restricted stock awards. To the extent realized tax deductions exceed the

amount of previously recognized deferred tax benefits related to share-based compensation, we record an excess tax benefit. We record all excess tax benefits as a component of income tax benefit or expense in the income statement in the period in which stock options are exercised or restrictions on awards lapse. We recorded excess tax benefits of \$13.9 million in the first nine months of 2018 compared to \$7.7 million in the same period of 2017.

Retained Deficit

We account for the retirement of treasury shares as a reduction of retained earnings (deficit). As of September 30, 2018, 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 \$1,278.2 million and cumulative dividends of \$477.1 million.

Accumulated Other Comprehensive Loss

The table below presents the components of our Accumulated other comprehensive loss balance (in thousands):

	September 30,		December
	2018	2017	31, 2017
Foreign currency translation adjustments	\$(9,692)	\$(7,370)	\$(7,478)
Unrealized gains (losses) on interest rate swaps, net of tax ⁽¹⁾	2,057	(379)	150
Accumulated other comprehensive loss	\$(7,635)	\$(7,749)	\$(7,328)

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance that allows entities the option to reclassify the tax effects related to items in accumulated other comprehensive income (loss) to retained earnings (deficit) if deemed to be stranded in accumulated other comprehensive income (loss) due to U.S. tax reform. We do not have any material amounts stranded in Accumulated other comprehensive loss as a result of U.S. tax reform.

Recent Accounting Pronouncements Pending Adoption

The following table summarizes the recent accounting pronouncements that we plan to adopt in future periods:

Standard	Description	Effective Date	Effect on Financial Statements and Other Significant Matters
ASU 2016-02, Leases	Requires lessees to record most leases on their balance sheets but recognize expenses in a manner similar to current guidance. The guidance is required to be applied using a modified retrospective approach.	Annual periods beginning after December 15, 2018	We believe the adoption of ASU 2016-02 will significantly increase assets and liabilities on our Consolidated Balance Sheets as we record a right-of-use asset and corresponding liability for each of our existing operating leases. We are currently testing all of the information we have gathered to properly account for the leases under the new standard and to quantify the balance sheet impacts. We are also implementing the related process changes and testing internal controls. Based on our current lease portfolio, we do not expect a material impact on our results of operations and cash flows. Upon adoption, we expect to apply the package of practical expedients available within the new standard, which is intended to provide some relief to issuers. We will also have expanded disclosures upon adoption of this new accounting pronouncement.

Standard	Description	Effective Date	Effect on Financial Statements and Other Significant Matters We are currently evaluating the effect this will have on our financial position, results of operations and related disclosures.
ASU 2017-12, Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities	Eliminates the requirement to separately measure and report hedge ineffectiveness. For qualifying cash flow and net investment hedges, the change in the fair value of the hedging instrument will be recorded in Other Comprehensive Income (OCI), and amounts deferred in OCI will be reclassified to earnings in the same income statement line item that is used to present the earnings effect of the hedged item.	Annual periods beginning after December 15, 2018	
ASU 2016-13, Financial Instruments - Credit Losses - Measurement of Credit Losses on Financial Instruments	Changes the way companies evaluate credit losses for most financial assets and certain other instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking “expected loss” model to evaluate impairment, potentially resulting in earlier recognition of allowances for losses. The new standard also requires enhanced disclosures, including the requirement to disclose the information used to track credit quality by year of origination for most financing receivables. The guidance must be applied using a cumulative-effect transition method.	Annual periods beginning after December 15, 2019	We are currently evaluating the effect this will have on our financial position, results of operations and related disclosures.
ASU 2017-04, Intangibles - Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment	Eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge (commonly referred to as Step 2 under the current guidance). Rather, the measurement of a goodwill impairment charge will be based on the excess of a reporting unit’s carrying value over its fair value (Step 1 under the current guidance). This guidance should be applied prospectively.	Annual and interim impairment tests performed in periods beginning after December 15, 2019	We are currently evaluating the effect this will have on our financial position, results of operations and related disclosures.

Note 2 – Earnings Per Share

We calculate basic earnings per share (EPS) by dividing Net income attributable to Pool Corporation by the weighted average number of common shares outstanding. We include outstanding unvested restricted stock awards of our common stock in the basic weighted average share calculation. Diluted EPS reflects the dilutive effects of potentially dilutive securities, which include in-the-money outstanding stock options and shares to be purchased under our employee stock purchase plan. Using the treasury stock method, the effect of dilutive securities includes these

additional shares of common stock that would have been outstanding based on the assumption that these potentially dilutive securities had been issued.

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,	
	2018	2017	2018	2017
Net income	\$69,261	\$48,783	\$217,649	\$165,674
Net loss attributable to noncontrolling interest	—	—	—	294
Net income attributable to Pool Corporation	\$69,261	\$48,783	\$217,649	\$165,968
Weighted average shares outstanding:				
Basic	40,422	40,659	40,416	41,065
Effect of dilutive securities:				
Stock options and employee stock purchase plan	1,375	1,548	1,415	1,626
Diluted	41,797	42,207	41,831	42,691
Earnings per share:				
Basic	\$1.71	\$1.20	\$5.39	\$4.04
Diluted	\$1.66	\$1.16	\$5.20	\$3.89
Anti-dilutive stock options excluded from diluted earnings per share computations	—	108	—	108

Note 3 – Acquisitions

In January 2018, we acquired Tore Pty. Ltd. (doing business as Pool Power), a wholesale distributor of pool and spa equipment in South Australia, with one distribution center in Adelaide, Australia.

In December 2017, we acquired the distribution assets of Chem Quip, Inc. (Chem Quip), a wholesale distributor of residential and commercial swimming pool equipment, chemicals and supplies, with five distribution locations in central and northern California.

In December 2017, we acquired Kripsol Intermark Malaga S.L. (Intermark), a swimming pool equipment and supplies distributor, with one location in southern Spain.

In October 2017, we acquired E-Grupa, a national swimming pool equipment and supplies distributor, with one location in Croatia.

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

In April 2017, we acquired the distribution assets of Lincoln Equipment, Inc. (doing business as Lincoln Aquatics), a national distributor of equipment and supplies to commercial and institutional swimming pool customers, with one location in California.

We have completed our acquisition accounting for these acquisitions. These acquisitions did not have a material impact on our financial position or results of operations, either individually or in the aggregate.

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 contract and our contingent consideration liabilities (in thousands):

	Fair Value at September 30, 2018 2017	
Level 2		
Unrealized gains on interest rate swaps	\$3,542	\$1,201
Unrealized losses on interest rate swaps	—	1,791
Level 3		
Contingent consideration liabilities	\$1,431	\$1,924

Interest Rate Swaps

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

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

We recognize any differences between the variable interest rate payments and the fixed interest rate settlements from our swap counterparties as an adjustment to interest expense over the life of the swaps. We designated these swaps as cash flow hedges, and to the extent effective we record the changes in the estimated fair value of the swaps to Accumulated other comprehensive loss on our Consolidated Balance Sheets. To the extent our interest rate swaps are determined to be ineffective, we recognize the changes in the estimated fair value of our swaps in earnings.

We currently have three interest rate swap contracts in place, which became effective on October 19, 2016. These swaps were previously forward-starting contracts that were amended in October 2015 to bring the fixed rates per our forward-starting contracts in line with current market rates and extend the hedged period for future interest payments

on our Credit Facility. As amended, these swap contracts terminate on November 20, 2019. In the first nine months of 2018, we recognized a benefit of \$1.5 million as a result of ineffectiveness for the period. These amounts were recorded in Interest and other non-operating expenses, net on our Consolidated Statements of Income.

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

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

Upon amendment of the original hedge agreements, we were required to freeze the amounts related to the changes in the fair values of these swap contracts in Accumulated other comprehensive loss. On September 30, 2018, these balances became fully amortized. In the first nine months of 2018, we recorded expense of \$1.4 million as amortization of the unrealized loss in Interest and other non-operating expenses, net.

For the three interest rate swap contracts in effect at September 30, 2018, a portion of the change in the estimated fair value between periods relates to future interest expense. Recognition of the change in fair value between periods attributable to accrued interest is reclassified from Accumulated other comprehensive loss on the Consolidated Balance Sheets to Interest and other non-operating expenses, net on the Consolidated Statements of Income. These amounts were not material in the nine month periods ended September 30, 2018 and September 30, 2017.

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

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

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

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

Contingent Consideration Liabilities

As of September 30, 2018, our Consolidated Balance Sheets reflected \$0.6 million in Accrued expenses and other current liabilities and \$0.8 million in Other long-term liabilities for contingent consideration related to future payouts for our acquisitions of The Melton Corporation (Melton), which we acquired in November 2015, Metro Irrigation Supply Company Ltd. (Metro), which we acquired in April 2016, and Newline Pool Products (Newline), which we acquired in July 2017.

In the first nine months of 2018, we paid approximately \$0.2 million in contingent consideration to Melton based on 2017 results. Since the acquisition dates, we have recorded immaterial adjustments to our original estimates based on

the calculated 2017 and 2018 payouts related to the respective fiscal years and estimated future payouts considering results through September 2018. 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, 2018, we have determined that the contingent consideration liability was in a range of acceptable estimates for all applicable periods.

Other

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

Note 5 – Debt

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

	September 30,	
	2018	2017
Variable rate debt		
Short-term borrowings	\$ 321	\$—
Current portion of long-term debt:		
Australian credit facility	9,022	8,609
Short-term borrowings and current portion of long-term debt	9,343	8,609
Long-term portion:		
Revolving credit facility	417,410	415,277
Receivables securitization facility	155,000	142,300
Less: financing costs, net	1,050	1,613
Long-term debt, net	571,360	555,964
Total debt	\$580,703	\$564,573

Our accounts receivable 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.

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 and have the ability 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.

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 2017 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, future dividend payments 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,” “intend,” “believe,” “will likely result,” “outlook,” “plan,” “project,” and other words and expressions of similar meaning. In addition, forward-looking statements and estimates regarding the effects of the Tax Cuts and Jobs Act, which are based on our current interpretation of this legislation and on reasonable estimates, may change as a result of new guidance issued by regulators or changes in our estimates.

No assurance can be given that the results in any forward-looking statements will be achieved and actual results may differ materially due to one or more factors, including the sensitivity of our business to weather conditions, changes in the economy and the housing market, our ability to maintain favorable relationships with suppliers and manufacturers, competition from other leisure product alternatives and mass merchants, excess tax benefits or deficiencies recognized under ASU 2016-09 and other risks detailed in our 2017 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 produced strong third quarter results thanks to our operational execution and a continuation of the elevated demand trends for discretionary pool and irrigation related products. Despite bouts of severe weather, with Hurricane Florence impacting the Carolinas, elevated rainfall in Texas and wildfires in California, we achieved favorable results. Net sales increased 9% to \$811.3 million in the third quarter of 2018 compared to \$743.4 million in the third quarter of 2017. Base business sales grew 8% over the same quarter of 2017, with demand for discretionary products such as building materials and our expanded commercial product offerings driving our sales growth.

Gross profit increased 8% to \$235.0 million in the third quarter of 2018 from \$216.6 million in the same period of 2017. Base business gross profit improved 8% over the third quarter of 2017. Gross profit as a percentage of net sales (gross margin) was 29.0% for the third quarter of 2018 compared to 29.1% for the third quarter of 2017. This decline in gross margin mainly reflects differences in product mix.

Selling and administrative expenses (operating expenses) increased 6% to \$142.7 million in the third quarter of 2018 compared to the third quarter of 2017, with base business operating expenses up 5% over the comparable 2017 period. We attribute the expense growth to variable labor and freight costs together with higher facility costs. As a percentage of net sales, base business operating expenses declined to 17.4% for the third quarter of 2018 compared to 18.0% for the third quarter of 2017.

Operating income for the third quarter of 2018 increased to \$92.3 million, up 13% compared to the same period in 2017. Operating income as a percentage of net sales (operating margin) was 11.4% for the third quarter of 2018 and 11.0% for the same period in 2017, while base business operating margin was 11.5% for the third quarter of 2018 and 11.2% for the same period in 2017.

Both Accounting Standards Update (ASU) 2016-09, Improvements to Employee Share-Based Payment Accounting, which we adopted on January 1, 2017, and U.S. tax reform enacted in December 2017 impacted our income tax provision for the third quarter of 2018. Our effective tax rate was 20.8% and 37.4% for the third quarters of 2018 and

2017, respectively. We recorded a \$3.3 million benefit from ASU 2016-09 in the quarter ended September 30, 2018 compared to a benefit of \$0.3 million realized in the same period in 2017. Excluding the benefits from ASU 2016-09, our effective tax rate was 24.6% and 37.9% for the third quarters of 2018 and 2017, respectively. As previously reported, we expect our annual effective tax rate (excluding the benefit from ASU 2016-09) for 2018 and future periods to approximate 25.5%, which is a reduction compared to our historical rate of approximately 38.5% due to the impact of the recent U.S. tax reform.

Net income attributable to Pool Corporation was \$69.3 million in the third quarter of 2018 compared to \$48.8 million in the third quarter of 2017. Earnings per share increased 43% to a record \$1.66 per diluted share for the three months ended September 30, 2018 compared to \$1.16 per diluted share for the same period in 2017. The reduction in our effective tax rate from 37.4% to 20.8% as discussed above reduced our income tax expense by approximately \$14.5 million, or \$0.35 per diluted share, in the third quarter of 2018.

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

Financial Position and Liquidity

As of September 30, 2018, total net receivables, including pledged receivables, increased 10% compared to September 30, 2017, primarily reflecting sales growth. Our days sales outstanding (DSO), as calculated on a trailing four quarters basis, was 30.2 days at September 30, 2018 and 29.8 days at September 30, 2017. Our allowance for doubtful accounts balance was \$5.4 million at September 30, 2018 and \$4.1 million at September 30, 2017.

Net inventory levels grew 26% compared to levels at September 30, 2017. The increase of \$125.7 million between periods reflects significant inventory purchases we made in the third quarter of 2018 in advance of greater-than-normal vendor price increases, as well as purchases needed to support normal business growth, and the addition of inventories from acquisitions. The inventory reserve was \$8.8 million at September 30, 2018 and \$7.8 million at September 30, 2017. Our inventory turns, as calculated on a trailing four quarters basis, was 3.4 times at September 30, 2018 and 3.5 times at September 30, 2017.

Total debt outstanding at September 30, 2018 was \$580.7 million, up 3% compared to total debt at September 30, 2017.

Current Trends and Outlook

For a detailed discussion of trends through 2017, see the Current Trends and Outlook section of Management's Discussion and Analysis included in Item 7 of our 2017 Annual Report on Form 10-K.

We project base business sales growth of approximately 7% for 2018. After a slower than normal start in March and April, activity returned to expected levels through the end of the third quarter with the main limitation being customer capacity. We believe that customer labor constraints and reduced work days due to higher rainfall in selected markets created a build up of demand in the second and third quarters, which will lead to ongoing sales growth in the fourth quarter of 2018 as demand remains strong. Due to product cost increases imposed by our vendors, which we have passed on to our customers, we also expect inflation to be closer to 2% in the fourth quarter of 2018 versus the historical average of 1% to 2%. We believe this factor will benefit our gross margin in the fourth quarter of 2018 and expect our full year 2018 gross margin to be similar to 2017.

We continue to expect base business operating expenses will grow at a rate that will enable us to achieve operating margin improvement of approximately 20 to 40 basis points for the full year 2018 compared to 2017. Through September, our operating margin has improved 20 basis points year to date and should improve to the upper end of our 20 to 40 basis points range by the end of the fourth quarter. Changes in non-executive performance-based compensation programs that impact the timing of our expense recognition resulted in higher compensation expense in the first half of 2018, primarily in the second quarter. We believe our fourth quarter results should particularly benefit from this timing change, as we observed some benefit in the third quarter. Inflationary pressure related to labor, fuel and freight continues to rise, but we expect our productivity plans will allow these cost increases to better correlate with sales volume growth and improve our operating leverage.

As discussed further in Results of Operations, our average outstanding debt for the nine months ended September 30, 2018 increased 14% over the same period last year, and given the increase in the 30-Day LIBOR, our effective interest rate increased approximately 60 basis points between periods. Based on these trends, we expect Interest and other non-operating expenses, net will increase roughly \$2.0 million in the fourth quarter of 2018 compared to the same period in 2017.

In 2018, we expect our effective tax rate to approximate 25.5%, which is a reduction from our historical rate of approximately 38.5%, both of which exclude the impact of ASU 2016-09. We have not finalized our accounting for the effects of tax reform; however, our estimated effective tax rate is based on reasonable estimates for the effects from tax reform at this time.

Our effective tax rate is dependent on our results of operations and may change if actual results differ materially from our current expectations, particularly any significant changes in our geographic mix. Due to ASU 2016-09 requirements, we expect our effective tax rate will fluctuate from quarter to quarter, particularly in periods when employees elect to exercise their vested stock options or when restrictions on share-based awards lapse. We recorded a \$13.9 million benefit from ASU 2016-09 for the nine months ended September 30, 2018. Additional tax benefits could be recognized related to stock option exercises in 2018 from grants that expire in years after 2018, for which we have not included any expected benefits in our guidance. The estimated impact related to ASU 2016-09 is subject to several assumptions which can vary significantly, including our estimated share price and the periods in which our employees will exercise vested stock options.

We have updated our 2018 earnings guidance range to \$5.58 to \$5.78 per diluted share from \$5.50 to \$5.70 per diluted share, which includes the tax benefits realized from ASU 2016-09 in the first nine months of 2018.

Given the timing changes in our inventory purchasing activity in 2018, we expect that cash provided by operations will be less than net income for the 2018 fiscal year. We expect an offsetting benefit in 2019 as our purchasing activity normalizes. We anticipate that we may use approximately \$100.0 million to \$150.0 million in cash for share repurchases in 2018.

RESULTS OF OPERATIONS

As of September 30, 2018, we conducted operations through 360 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, 2018		Nine Months Ended September 30, 2018	
	2018	2017	2018	2017
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	71.0	70.9	71.1	71.0
Gross profit	29.0	29.1	28.9	29.0
Operating expenses	17.6	18.1	17.2	17.2
Operating income	11.4	11.0	11.7	11.7
Interest and other non-operating expenses, net	0.6	0.5	0.6	0.5
Income before income taxes and equity earnings	10.8 %	10.5 %	11.1 %	11.2 %

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

We have included the results of operations from the acquisitions in 2018 and 2017 in our consolidated results since the acquisition dates.

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

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

(Unaudited) (in thousands)	Base Business		Excluded		Total	
	Three Months Ended		Three Months Ended		Three Months Ended	
	September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017
Net sales	\$800,971	\$738,391	\$10,340	\$5,010	\$811,311	\$743,401
Gross profit	231,841	215,078	3,162	1,528	235,003	216,606
Gross margin	28.9	% 29.1	% 30.6	% 30.5	% 29.0	% 29.1
Operating expenses	139,392	132,663	3,274	2,015	142,666	134,678
Expenses as a % of net sales	17.4	% 18.0	% 31.7	% 40.2	% 17.6	% 18.1
Operating income (loss)	92,449	82,415	(112)	(487)	92,337	81,928
Operating margin	11.5	% 11.2	% (1.1)	% (9.7)	% 11.4	% 11.0

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

	Acquisition	Net	Periods
Acquired	Date	Sales Centers	Acquired
Pool Power ⁽¹⁾	January 2018	1	July - September 2018
Chem Quip ⁽¹⁾	December 2017	5	July - September 2018
Intermark	December 2017	1	July - September 2018
E-Grupa	October 2017	1	July - September 2018
Newline Pool Products	July 2017	1	July - September 2018 and
Lincoln Aquatics ⁽¹⁾	April 2017	1	July - September 2017
			July 2018 and July 2017

⁽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 2018:

December 31, 2017	351
Acquired location	1
New locations	9
Consolidated location (1)	
September 30, 2018	360

Net Sales

	Three Months Ended September 30,		
(in millions)	2018	2017	Change
Net sales	\$811.3	\$743.4	\$67.9 9%

Net sales increased 9% in the third quarter of 2018 compared to the third quarter of 2017, with base business sales up 8% for the period. Despite severe weather events, with Hurricane Florence impacting the Carolinas, elevated rainfall in Texas and wildfires in California, we achieved favorable results.

The following factors benefited our sales (listed in order of estimated magnitude):

- strong demand for discretionary products, as evidenced by improvements in sales growth rates for product offerings such as building materials and equipment (see discussion below);
- market share gains, particularly in building materials and commercial products (see discussion below); and
- inflationary product cost increases (estimated at approximately 1%).

We believe that sales growth rates for certain product offerings, such as building materials and equipment, evidence increased spending in traditionally discretionary areas, such as pool construction, pool remodeling and equipment upgrades. In the third quarter of 2018, sales for equipment, which includes swimming pool heaters, pumps, lights and filters, increased approximately 8% compared to the same period last year. These products collectively represented approximately 25% of net sales for the period. Sales of building materials grew 16% compared to the third quarter of 2017 and represented approximately 11% of net sales in the third quarter of 2018.

Sales to customers who service large commercial swimming pools such as hotels, universities and community recreational facilities are included in the appropriate existing product categories, and growth in this area is reflected in the numbers above. Sales to these customers represented approximately 4% of our consolidated net sales for the third quarter of 2018 and increased 9% compared to the third quarter of 2017.

Gross Profit

	Three Months Ended September 30,		
(in millions)	2018	2017	Change
Gross profit	\$235.0	\$216.6	\$18.4 8%
Gross margin	29.0 %	29.1 %	

The slight decline in gross margin between periods primarily reflects minor product mix differences.

Operating Expenses

	Three Months Ended September 30,		
(in millions)	2018	2017	Change
Operating expenses	\$142.7	\$134.7	\$8.0 6%
Operating expenses as a % of net sales	17.6 %	18.1 %	

Operating expenses increased 6% in the third quarter of 2018 compared to the third quarter of 2017, with base business operating expenses up approximately 5% compared to the same period last year. This increase reflects variable labor and freight costs together with higher facility costs.

Interest and Other Non-Operating Expenses, Net

Interest and other non-operating expenses, net for the third quarter of 2018 increased \$0.9 million compared to the third quarter of 2017. The increase mostly reflects higher interest expense on our debt. Our weighted average effective interest rate increased to 3.3% for the third quarter of 2018 from 2.7% for the third quarter of 2017 on higher average outstanding debt of \$566.2 million versus \$535.5 million for the respective periods.

Income Taxes

Our effective income tax rate was 20.8% for the three months ended September 30, 2018 and 37.4% for the three months ended September 30, 2017. Both ASU 2016-09 and U.S. tax reform impacted our income tax provision for the third quarter of 2018. We recorded a \$3.3 million benefit from ASU 2016-09 in the quarter ended September 30, 2018 compared to a benefit of \$0.3 million realized in the same period last year. Excluding the benefits from ASU 2016-09, our effective tax rate was 24.6% and 37.9% for the third quarters of 2018 and 2017, respectively, mostly reflecting the lower corporate income tax rate enacted as part of U.S. tax reform.

Net Income and Earnings Per Share

Net income attributable to Pool Corporation increased 42% to \$69.3 million in the third quarter of 2018 compared to the third quarter of 2017. Earnings per diluted share increased to \$1.66 for the third quarter of 2018 versus \$1.16 per diluted share for the comparable 2017 period. The reduction in our effective tax rate from 37.4% to 20.8% as discussed above reduced our income tax expense by approximately \$14.5 million, or \$0.35 per diluted share, in the third quarter of 2018.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

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

(Unaudited) (in thousands)	Base Business		Excluded		Total	
	Nine Months Ended		Nine Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017
Net sales	\$2,419,766	\$2,266,386	\$35,249	\$11,619	\$2,455,015	\$2,278,005
Gross profit	699,058	656,433	10,674	3,458	709,732	659,891
Gross margin	28.9	% 29.0	% 30.3	% 29.8	% 28.9	% 29.0
Operating expenses	409,791	388,299	12,021	4,480	421,812	392,779
Expenses as a % of net sales	16.9	% 17.1	% 34.1	% 38.6	% 17.2	% 17.2
Operating income (loss)	289,267	268,134	(1,347)	(1,022)	287,920	267,112
Operating margin	12.0	% 11.8	% (3.8)	% (8.8)	% 11.7	% 11.7

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

	Acquisition	Net	Periods
Acquired	Date	Sales Centers	Excluded
		Acquired	
Pool Power ⁽¹⁾	January 2018	1	January - September 2018
Chem Quip ⁽¹⁾	December 2017	5	January - September 2018
Intermark	December 2017	1	January - September 2018
E-Grupa	October 2017	1	January - September 2018
Newline Pool Products	July 2017	1	January - September 2018 and July - September 2017
Lincoln Aquatics ⁽¹⁾	April 2017	1	January - July 2018 and May - July 2017

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

For a more detailed explanation of how we calculated base business results and a summary of the changes in our sales centers since December 31, 2017, please refer to the discussion under the heading Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017.

Net Sales

	Nine Months Ended September 30,		
(in millions)	2018	2017	Change
Net sales	\$2,455.0	\$2,278.0	\$177.0 8%

Net sales for the first nine months of 2018 increased 8% compared to the same period last year, with most of this growth resulting from the 7% improvement in base business sales. We started the year off strong, but multiple storms in March hindered our customers' ability to complete projects, and cold temperatures and snow in our seasonal markets delayed pool openings through April. Our seasonal markets finally warmed up in May 2018, allowing us to serve the pent-up demand and generate solid sales growth through the remainder of the second and third quarters, despite several occurrences of severe weather in the third quarter of 2018.

The following factors benefited our sales (listed in order of estimated magnitude):

- strong demand for discretionary products, as evidenced by improvements in sales growth rates for product offerings such as building materials and equipment (see discussion below);
- market share gains, particularly in building materials and commercial products (see discussion below);
- sales growth of 8% from irrigation products which represented 9% of net sales; and
- inflationary product cost increases (estimated at approximately 1%).

We believe that sales growth rates for certain product offerings, such as building materials and equipment, evidence increased spending in traditionally discretionary areas, such as pool construction, pool remodeling and equipment upgrades. In the first nine months of 2018, sales for equipment, which includes swimming pool heaters, pumps, lights and filters, increased approximately 8% compared to the same period last year. These products collectively represented 26% of net sales in the first nine months of 2018. Sales of building materials grew 12% compared to the first nine months of 2017 and represented approximately 12% of net sales in the first nine months of 2018.

Sales to customers who service large commercial swimming pools such as hotels, universities and community recreational facilities are included in the appropriate existing product categories, and growth in this area is reflected in the numbers above. Sales to these customers represented approximately 5% of our consolidated net sales in the first nine months of 2018 and increased 10% compared to the same period in 2017.

Gross Profit

	Nine Months Ended September 30,		
(in millions)	2018	2017	Change
Gross profit	\$709.7	\$659.9	\$49.8 8%
Gross margin	28.9 %	29.0 %	

The slight decline in gross margin between periods primarily reflects minor product mix differences.

Operating Expenses

Nine Months
Ended
September 30,

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(in millions)	2018	2017	Change
Operating expenses	\$421.8	\$392.8	\$29.0 7%
Operating expenses as a % of net sales	17.2 %	17.2 %	

For the first nine months of 2018, operating expenses increased 7% over the same period last year, with base business operating expenses up 6%. Higher costs related to labor, technology, facilities and vehicles contributed to this increase.

Interest and Other Non-Operating Expenses, Net

Interest and other non-operating expenses, net for the first nine months of 2018 increased \$2.8 million compared to the same period last year. The increase mostly reflects higher interest expense on our debt. Our weighted average effective interest rate increased to 3.2% for the first nine months of 2018 from 2.6% for the same period of 2017 on higher average outstanding debt of \$569.5 million versus \$501.0 million for the respective periods.

Income Taxes

Our effective income tax rate was 20.5% for the nine months ended September 30, 2018 compared to 35.2% for the nine months ended September 30, 2017. Both ASU 2016-09 and U.S. tax reform impacted our income tax provision for the first nine months of 2018. We recorded a \$13.9 million benefit from ASU 2016-09 for the nine months ended September 30, 2018 compared to the \$7.7 million benefit realized in the same period last year. Excluding the benefits from ASU 2016-09, our effective tax rate was 25.5% and 38.2% for the nine months ended September 30, 2018 and September 30, 2017, respectively, mostly reflecting the lower corporate income tax rate enacted as part of U.S. tax reform.

Net Income and Earnings Per Share

Net income attributable to Pool Corporation increased 31% to \$217.6 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Earnings per diluted share increased to \$5.20 for the nine months ended September 30, 2018 versus \$3.89 per diluted share for the nine months ended September 30, 2017. The reduction in our effective tax rate from 35.2% to 20.5% as discussed above reduced our income tax expense by approximately \$40.3 million, or \$0.96 per diluted share, in the first nine months of 2018.

Seasonality and Quarterly Fluctuations

Our business is highly seasonal. In general, sales and operating income are highest during the second and third quarters, which represent the peak months of both swimming pool use and installation and landscape maintenance and installation. Sales are substantially lower during the first and fourth quarters, when we may incur net losses. In 2017, we generated approximately 62% of our net sales and 83% of our operating income in the second and third quarters of the year.

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

The following table presents certain unaudited quarterly data for the first, second and third quarters of 2018, the four quarters of 2017 and the fourth quarter of 2016. We have included income statement and balance sheet data for the most recent eight quarters to allow for a meaningful comparison of the seasonal fluctuations in these amounts. In our opinion, this information reflects all normal and recurring adjustments considered necessary for a fair presentation of this data. Due to the seasonal nature of our industry, the results of any one or more quarters are not necessarily a good indication of results for an entire fiscal year or of continuing trends.

(Unaudited) (in thousands)	QUARTER							
	2018 Third	Second	First	2017 Fourth	Third	Second	First	2016 Fourth
Statement of Income Data								
Net sales	\$811,311	\$1,057,804	\$585,900	\$510,183	\$743,401	\$988,163	\$546,441	\$445,235
Gross profit	235,003	308,655	166,073	145,398	216,606	289,664	153,621	127,777
Operating income	92,337	162,042	33,541	17,259	81,928	154,186	30,998	9,743
Net income	69,261	117,049	31,339	25,665	48,783	94,620	22,270	2,572
Balance Sheet Data								
Total receivables, net	\$287,773	\$404,415	\$314,596	\$196,265	\$262,796	\$370,285	\$290,019	\$166,151
Product inventories, net	609,983	606,583	703,793	536,474	484,287	542,805	647,884	486,116
Accounts payable	204,706	300,232	467,795	245,249	209,062	273,309	465,928	230,728
Total debt	580,703	657,120	568,110	519,650	564,573	553,480	490,217	438,042

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

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

Weather	Possible Effects
Hot and dry	• Increased purchases of chemicals and supplies for existing swimming pools • Increased purchases of above-ground pools and irrigation products
Unseasonably cool weather or extraordinary amounts of rain	• Fewer pool and landscape installations • Decreased purchases of chemicals and supplies • Decreased purchases of impulse items such as above-ground pools and accessories
Unseasonably early warming trends in spring/late cooling trends in fall (primarily in the northern half of the U.S. and Canada)	• A longer pool and landscape season, thus positively impacting our sales
Unseasonably late warming trends in spring/early cooling trends in fall (primarily in the northern half of the U.S. and Canada)	• A shorter pool and landscape season, thus negatively impacting our sales

Weather Impacts on 2018 and 2017 Results

California wildfires, large amounts of rain throughout Texas, and Hurricane Florence in the Carolinas all impacted our sales in the third quarter of 2018. Likewise, severe storms in the third quarter of 2017, particularly Hurricanes Irma and Harvey, hindered our sales growth in Florida and Texas last year, although Texas largely recovered by the end of September 2017. In the third quarter of 2018, the West experienced record heat and below average rainfall, while temperatures were also above average in the central United States and the Midwest, but each experienced above average rainfall. These weather patterns were consistent with that experienced in the third quarter of last year, resulting in overall similar weather comparisons.

While warming trends started out slow in the second quarter of 2018, the unfavorable weather comparisons turned around by the end of the quarter. With the exception of Florida, where it rained most of May and into June, and California, which generally experienced a cooler-than-usual spring, 2018 results in the last two months of the second quarter benefited from the warm weather throughout the country and helped relieve the effects of the slow start from earlier in the year. April 2018 sales struggled as much of the country experienced cold to record cold temperatures this year, in contrast to warm to record warm temperatures in 2017.

Storm activity, as well as cooler-than-normal temperatures late in the first quarter of 2018, inhibited our first quarter sales growth. Much of the Atlantic Coast experienced below-average temperatures in March of 2018, which caused pools to open later than in 2017, while greater storm activity in Texas and the central United States and above average precipitation in California delayed construction activity during the first quarter of 2018. In contrast, unseasonably mild weather benefited sales in the first quarter of 2017, as Texas and surrounding markets experienced record warm temperatures.

LIQUIDITY AND CAPITAL RESOURCES

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

- cash flows generated from operating activities;
- the adequacy of available bank lines of credit;
- the quality of our receivables;
- acquisitions;
- dividend payments;
- capital expenditures;
- changes in income tax laws and regulations;
- the timing and extent of share repurchases; and
- the ability to attract long-term capital with satisfactory terms.

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

We prioritize our use of cash based on investing in our business, maintaining a prudent debt structure, including a modest amount of debt, and returning cash to our shareholders through dividends and share repurchases. Our specific priorities for the use of cash are as follows:

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

Capital expenditures were 1.4% of net sales in 2017 as we expanded facilities and purchased vehicles to address growth opportunities. Capital expenditures were 1.4% of net sales in 2016 and 1.0% of net sales in 2015. Over the last five years, capital expenditures have averaged roughly 1.0% of net sales. Going forward, we project capital expenditures will approximate this average.

Sources and Uses of Cash

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

	Nine Months Ended	
	September 30,	
	2018	2017
Operating activities	\$51,260	\$112,020
Investing activities	(28,554)	(44,584)
Financing activities	(17,339)	(52,746)

Cash provided by operating activities decreased \$60.8 million during the first nine months of 2018 compared to the first nine months of 2017 primarily due to timing differences from pre-price increase inventory purchases in 2018, which should benefit future periods' cash flows as the inventory is sold. In 2018, we increased our inventory purchases in advance of greater than normal vendor price increases, which negatively impacted operating cash flow, but should positively impact operating income for the remainder of 2018 and into fiscal 2019.

Cash used in investing activities for the first nine months of 2018 decreased compared to the first nine months of 2017 primarily due to earlier-than-normal vehicle additions to our fleet in the first nine months of last year as well as the Lincoln Aquatics acquisition that occurred in the second quarter of 2017.

Cash used in financing activities decreased for the first nine months of 2018 compared to the first nine months of 2017, which reflects a \$102.7 million decline in share repurchases offset by a \$66.6 million decrease in amounts provided by net borrowings.

Future Sources and Uses of Cash

Revolving Credit Facility

Our Credit Facility provides for \$750.0 million in borrowing capacity under a five-year unsecured revolving credit facility and includes sublimits for the issuance of swingline loans and standby letters of credit. Pursuant to an accordion feature, the aggregate maximum principal amount of the commitments under the Credit Facility may be increased at our request and with agreement by the lenders by up to \$75.0 million, to a total of \$825.0 million. The Credit Facility matures on September 29, 2022. We intend to use the Credit Facility for general corporate purposes, for future share repurchases and to fund future growth initiatives.

At September 30, 2018, there was \$417.4 million outstanding, a \$4.8 million standby letter of credit outstanding and \$327.8 million available for borrowing under the Credit Facility. We utilize interest rate swap contracts and forward-starting interest rate swap contracts to reduce our exposure to fluctuations in variable interest rates for future interest payments on the Credit Facility. As of September 30, 2018, we had three interest rate swap contracts in place that became effective on October 19, 2016. These swap contracts were previously forward-starting and were amended in October 2015 to bring the fixed rates per our forward-starting contracts in line with current market rates and extend the hedged period for future interest payments on our Credit Facility. Now effective, these amended swap contracts convert the Credit Facility's variable interest rate to fixed rates of 2.273% on a notional amount of \$75.0 million and 2.111% on two separate notional amounts, one \$25.0 million and the other \$50.0 million, totaling \$75.0 million. Interest expense related to the notional amounts under these swap contracts is based on the fixed rates plus the applicable margin on the Credit Facility. These interest rate swap contracts will terminate on November 20, 2019. In July 2016, we entered into a forward-starting interest rate swap contract to extend the hedged period for future interest payments on our Credit Facility to its maturity date at that time. This swap contract will convert the Credit Facility's variable interest rate to a fixed rate of 1.1425% on a notional amount of \$150.0 million. The contract becomes effective on November 20, 2019 and terminates on November 20, 2020.

The weighted average effective interest rate for the Credit Facility as of September 30, 2018 was approximately 3.2%, excluding commitment fees.

Financial covenants on the Credit Facility include maintenance of a maximum average total leverage ratio and a minimum fixed charge coverage ratio. As of September 30, 2018, the calculations of these two covenants are detailed below:

Maximum Average Total Leverage Ratio. On the last day of each fiscal quarter, our average total leverage ratio must be less than 3.25 to 1.00. Average Total Leverage Ratio is the ratio of the trailing twelve months (TTM) Average Total Funded Indebtedness plus the TTM Average Accounts Securitization Proceeds divided by the TTM EBITDA (as those terms are defined in the Credit Facility). As of September 30, 2018, our average total leverage ratio equaled 1.68 (compared to 1.72 as of June 30, 2018) and the TTM average total debt amount used in this calculation was \$577.8 million.

Minimum Fixed Charge Coverage Ratio. On the last day of each fiscal quarter, our fixed charge ratio must be greater than or equal to 2.25 to 1.00. Fixed Charge Ratio is the ratio of the TTM EBITDAR divided by TTM Interest Expense paid or payable in cash plus TTM Rental Expense (as those terms are defined in the Credit Facility). As of September 30, 2018, our fixed charge ratio equaled 5.44 (compared to 5.40 as of June 30, 2018) and TTM Rental Expense was \$56.7 million.

On January 1, 2019, we will adopt ASU 2016-02, Leases, which will require that we record most of our leases on our balance sheets, but we expect to recognize expenses in a manner similar to current guidance. Our Credit Facility

agreement requires that we calculate our financial covenants by excluding the effects of the new standard. We do not expect ASU 2016-02 will have a material impact on our financial covenant calculations.

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

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

Receivables Securitization Facility

Our two-year accounts receivable securitization facility (the Receivables Facility) offers us a lower cost form of financing, with a peak funding capacity of up to \$255.0 million between May 1 and June 30, which includes an additional seasonal funding capacity that is available between March 1 and July 31. Other funding capacities range from \$80.0 million to \$220.0 million throughout the remaining months of the year.

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

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

At September 30, 2018, there was \$155.0 million outstanding under the Receivables Facility at a weighted average effective interest rate of 3.0%, excluding commitment fees.

Compliance and Future Availability

As of September 30, 2018, we believe we were in compliance with all covenants and financial ratio requirements under our Credit Facility and our Receivables Facility. We believe we will remain in compliance with all covenants and financial ratio requirements throughout the next twelve months. For additional information regarding our debt arrangements, see Note 5 of "Notes to Consolidated Financial Statements," included in Item 8 of our 2017 Annual Report on Form 10-K.

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

As of October 25, 2018, \$186.1 million of the current Board authorized amount under our share repurchase program remained available. We expect to repurchase additional shares on the open market from time to time depending on market conditions. We plan to fund these repurchases with cash provided by operations and borrowings under the Credit and Receivables Facilities.

CRITICAL ACCOUNTING ESTIMATES

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

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

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

Management has discussed the development, selection and disclosure of our critical accounting estimates with the Audit Committee of our Board. For a description of our critical accounting estimates that require us to make the most difficult, subjective or complex judgments, please see our 2017 Annual Report on Form 10-K. We have not changed these policies from those previously disclosed.

Recent Accounting Pronouncements

See Note 1 of “Notes to Consolidated Financial Statements,” included in Item 1 of this Form 10-Q for detail.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

There have been no material changes during the nine months ended September 30, 2018 from what we reported in our 2017 Annual Report on Form 10-K. For additional information on our interest rate risk, refer to “Quantitative and Qualitative Disclosures about Market Risk” included in Part II, Item 7A. in our 2017 Annual Report on Form 10-K.

Currency Risk

There have been no material changes during the nine months ended September 30, 2018 from what we reported in our 2017 Annual Report on Form 10-K. For additional information on our currency risk, refer to “Quantitative and Qualitative Disclosures about Market Risk” included in Part II, Item 7A. in our 2017 Annual Report on Form 10-K.

Item 4. Controls and Procedures

The term “disclosure controls and procedures” is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Act). The rules refer to the controls and other procedures designed to ensure that information required to be disclosed in reports that we file or submit under the Act is (1) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and (2) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. As of September 30, 2018, management, including the CEO and CFO, performed an evaluation of the effectiveness of our disclosure controls and procedures. Based on that evaluation, management, including the CEO and CFO, concluded that as of September 30, 2018, our disclosure controls and procedures were effective.

We maintain a system of internal control over financial reporting that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Based on the most recent evaluation, we have concluded that no change in our internal control over financial reporting occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are subject to various claims and litigation arising in the ordinary course of business, including product liability, personal injury, commercial, contract and employment matters. While the outcome of any litigation is inherently unpredictable, based on currently available facts we do not believe that the ultimate resolution of any of these matters will have a material adverse impact on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part I, Item 1A “Risk Factors” in our 2017 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below summarizes the repurchases of our common stock in the third quarter of 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (2)	Maximum Approximate Dollar Value of Shares That May Yet be Purchased Under the Plan (3)
July 1 - 31, 2018	198	\$ 153.25	—	\$218,340,678
August 1 - 31, 2018	—	\$—	—	\$218,340,648
September 1 - 30, 2018	—	\$—	—	\$218,340,678
Total	198	\$ 153.25	—	

These shares may include shares of our common stock surrendered to us by employees in order to satisfy minimum tax withholding obligations in connection with certain exercises of employee stock options or lapses upon vesting of restrictions on previously restricted share awards, and/or to cover the exercise price of such options granted under our share-based compensation plans. All 198 shares were surrendered for this purpose in the third quarter of 2018.

In May 2018, our Board authorized an additional \$200.0 million under our share repurchase program for the repurchase of shares of our common stock in the open market at prevailing market prices or in privately negotiated transactions.

As of October 25, 2018, \$186.1 million of the authorized amount remained available under our current share repurchase program.

Item 6. Exhibits

Exhibits filed as part of this report are listed below.

No.	Description	Filed/ Furnished with this Form 10-Q	Incorporated by Reference		
			Form	File No.	Date Filed
<u>3.1</u>	Restated Certificate of Incorporation of the Company.		10-Q	000-26640	8/9/2006
<u>3.2</u>	Amended and Restated Bylaws of the Company.		8-K	000-26640	12/20/2012
<u>4.1</u>	Form of certificate representing shares of common stock of the Company.		8-K	000-26640	5/19/2006
<u>31.1</u>	Certification by Mark W. Joslin pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
<u>31.2</u>	Certification by Manuel J. Perez de la Mesa pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
<u>32.1</u>	Certification by Manuel J. Perez de la Mesa and Mark W. Joslin furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
101.INS	+XBRL Instance Document	X			
101.SCH	+XBRL Taxonomy Extension Schema Document	X			
101.CAL	+XBRL Taxonomy Extension Calculation Linkbase Document	X			
101.DEF	+XBRL Taxonomy Extension Definition Linkbase Document	X			
101.LAB	+XBRL Taxonomy Extension Label Linkbase Document	X			
101.PRE	+XBRL Taxonomy Extension Presentation Linkbase Document	X			
+ Attached as Exhibit 101 to this report are the following items formatted in XBRL (Extensible Business Reporting Language):					
1.	Consolidated Statements of Income for the three and nine months ended September 30, 2018 and September 30, 2017;				
2.	Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and September 30, 2017;				
3.	Consolidated Balance Sheets at September 30, 2018, December 31, 2017 and September 30, 2017;				
4.	Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and September 30, 2017; and				
5.	Notes to Consolidated Financial Statements.				

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on October 30, 2018.

POOL CORPORATION

By: /s/ Mark W. Joslin
 Mark W. Joslin
 Senior Vice President and Chief Financial Officer, and duly authorized signatory on behalf of the
 registrant