

POOL CORP
Form 10-K
March 01, 2011

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

FORM 10-K

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

For the fiscal year ended December 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
(State or other jurisdiction of
incorporation or organization)

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

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

70433-5001
(Zip Code)

985-892-5521
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	NASDAQ Global Select Market

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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES NO

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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 Act). YES NO

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant based on the closing sales price of the Registrant's common stock as of June 30, 2010 was \$1,042,907,678.

As of February 22, 2011, the Registrant had 48,847,864 shares of common stock outstanding.

Documents Incorporated by Reference

Portions of the Registrant's Proxy Statement to be mailed to stockholders on or about March 28, 2011 for the Annual Meeting to be held on May 4, 2011, are incorporated by reference in Part III of this Form 10-K.

POOL CORPORATION

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PART I.

Item 1. Business

General

Based on industry data, Pool Corporation (the Company, which may be referred to as we, us or our) is the world's largest wholesale distributor of swimming pool supplies, equipment and related leisure products and is one of the top three distributors of irrigation and landscape products in the United States. The Company was incorporated in the State of Delaware in 1993 and has grown from a regional distributor to a multi-national, multi-network distribution company.

Our industry is highly fragmented, and as such, we add considerable value to the industry by purchasing products from a large number of manufacturers and then distributing the products to our customer base on conditions that are more favorable than our customers could obtain on their own.

As of December 31, 2010, we operated 291 sales centers in North America and Europe through our three distribution networks:

- SCP Distributors LLC (SCP);
- Superior Pool Products LLC (Superior); and
- Horizon Distributors, Inc. (Horizon).

Superior and Horizon are both wholly owned subsidiaries of SCP, which is wholly owned by Pool Corporation.

Our Industry

We believe that the swimming pool industry is relatively young, with room for continued growth from increased penetration of new pools. Of the approximately 80 million homes in the United States that have the economic capacity and the yard space to have a swimming pool, approximately 12% currently have a pool. We believe favorable demographic and socioeconomic trends have and will continue to positively impact the long-term prospects of our industry. These favorable trends include the following:

- long-term growth in housing units in warmer markets due to the population migration towards the south, which contributes to the growing installed base of pools that homeowners must maintain;
- increased homeowner spending on outdoor living spaces for relaxation and entertainment; and
- consumers bundling the purchase of a swimming pool and other products, with new irrigation systems and landscaping often being key components to both pool installations and remodels.

The irrigation and landscape industry shares many characteristics with the pool industry, and we believe that it benefits from the same favorable demographic and socioeconomic trends and will realize long-term growth rates similar to the pool industry.

Approximately 70% of consumer spending in the pool industry is for maintenance and minor repair of existing swimming pools. Maintaining proper chemical balance and the related upkeep and repair of swimming pool equipment, such as pumps, heaters, filters and safety equipment, creates a non-discretionary demand for pool chemicals, equipment and other related parts and supplies. We also believe cosmetic considerations such as a pool's appearance and the overall look of backyard environments create an ongoing demand for other maintenance related goods and certain discretionary products.

We believe that the recurring nature of the maintenance and repair market has historically helped maintain a relatively consistent rate of industry growth. This has also helped cushion the negative impact on revenues in periods when unfavorable economic conditions and softness in the housing market have adversely impacted pool construction and major repair and refurbishment activities.

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The table below reflects growth in the domestic installed base of in-ground and above-ground swimming pools over the past 11 years (based on Company estimates and information from 2010 P.K. Data, Inc. reports):

The replacement and refurbishment market includes major swimming pool repairs and currently accounts for approximately 20% of consumer spending in the pool industry. This activity is more sensitive to economic factors that impact consumer spending compared to the maintenance and minor repair market.

New swimming pool construction comprises the bulk of the remaining 10% of consumer spending in the pool industry. The demand for new pools is driven by the perceived benefits of pool ownership including relaxation, entertainment, family activity, exercise and convenience. The industry competes for new pool sales against other discretionary consumer purchases such as kitchen and bathroom remodeling, boats, motorcycles, recreational vehicles and vacations.

The landscape and irrigation distribution business is split between residential and commercial markets, with the majority of sales related to the residential market. Landscape and irrigation maintenance activities account for 40% of total spending in the irrigation industry, with the remaining 60% of spending related to irrigation construction and other discretionary related products. As such, our irrigation business is more heavily weighted towards the sale of discretionary related products compared to our pool business and is therefore more sensitive to economic factors that impact consumer spending.

General economic conditions (as commonly measured by Gross Domestic Product or GDP), the availability of consumer credit and certain trends in the housing market affect our industry, particularly new pool and irrigation system starts. Positive GDP trends may have a favorable impact on industry starts, while negative trends may be unfavorable for industry starts. We believe that similar to trends for other home improvement expenditures, there is a direct correlation between industry starts and the rate of housing turnover and home appreciation over time, with higher rates of home turnover and appreciation having a positive impact on starts over time. We also believe that homeowners' access to consumer credit is a critical factor enabling the purchase of new swimming pools and irrigation systems.

The adverse housing and economic trends over the past several years had a significant impact on our industry and our performance. These trends drove an approximate 80% reduction in new pool construction in the United States compared to peak levels in 2005 and also contributed to more than a 30% decline in replacement and refurbishment activities. The impact of these trends was more severe in some of the largest pool markets including California, Florida and Arizona. Since irrigation is more heavily weighted towards new construction activities, the impact was greater on our Horizon business due to the significant declines in new home and commercial construction activities. In order to mitigate the greater rate of earnings decline for our irrigation business, we have consolidated several facilities and have significantly reduced operating costs related to our Horizon network over the past two years.

While general external market factors including consumer confidence, employment, consumer financing and economic growth remain at depressed levels, these factors have shown recent signs of improvement and we believe our 2% base business sales growth in 2010 indicates that the declines in pool construction and pool refurbishment activities have subsided in most markets. Trends that impact our landscape and irrigation markets tend to lag the trends in the corresponding pool markets by up to a year. Consistent with this expectation, trends on the irrigation side of our business began to improve during 2010 with slowly moderating sales declines highlighted by a number of markets realizing sales growth in the second half of the year and higher sales overall in December 2010 compared to December 2009.

We still believe there is potential for a significant sales recovery due to the build-up of deferred replacement and retrofit activity and our expectation for gradually normalized new pool and irrigation construction levels. While current economic trends indicate that consumer spending may rebound slowly and that construction activities in many markets will likely remain near current depressed levels through 2011, we believe that new pool and irrigation construction activities will gradually return to more normalized levels. We expect that sales levels should once again benefit from long-term industry growth dynamics and that over the long-term the industry will return to an annual growth rate of approximately 2% to 6% when the overall economy rebounds and the real estate and credit markets recover.

Our industry is seasonal and weather is one of the principal external factors that affect our business. Peak industry activity occurs during the warmest months of the year, typically April through September. Unseasonable warming or cooling trends can delay or accelerate the start or end of the pool and landscape season, impacting our maintenance and repair sales. These impacts at the shoulders of the season are generally more pronounced in northern markets. Weather also impacts our sales of construction and installation products to the extent that above average precipitation, late spring thaws in northern markets and other extreme weather conditions delay, interrupt or cancel current or planned construction and installation activities.

The industry is also affected by other factors including, but not limited to, consumer attitudes toward pool and landscape products for environmental or safety reasons.

Business Strategy and Growth

Our mission is to provide exceptional value to our customers and suppliers, in order to provide exceptional return to our shareholders while providing exceptional opportunities to our employees. Our three core strategies are as follows:

- to promote the growth of our industry;
- to promote the growth of our customers' businesses; and
- to continuously strive to operate more effectively.

We promote the growth of the industry through various advertising and promotional programs intended to raise consumer awareness of the benefits and affordability of pool ownership, the ease of pool maintenance and the many ways in which a pool and the surrounding spaces may be enjoyed beyond swimming. These programs include media advertising, industry-oriented website development such as www.swimmingpool.comTM, public relations campaigns and other online marketing initiatives including social media. We use these programs as tools to educate consumers and lead prospective pool owners to our customers.

We promote the growth of our customers' businesses by offering comprehensive support programs that include promotional tools and marketing support to help our customers generate increased sales. Our uniquely tailored programs include such features as customer lead generation, personalized websites, brochures, marketing campaigns and business development training. As a customer service, we also provide certain retail store customers assistance with everything from site selection to store layout and design to business management system implementation.

Growth initiatives related to our customer programs include our retail brand licensing program called The Backyard Place® and our Pool Pro 1 rewards program designed for pool service professionals. We launched The Backyard Place® program in 2006 and currently have over 100 agreements with retail store customers. Under this program, customers make commitments to meet minimum purchase levels, stock a minimum of nine specific product categories and operate within The Backyard Place® guidelines (including weekend hour requirements). Our Pool Pro 1 program aligns with our replacement parts growth initiative and provides customers with monthly coupons and other special

discounts on parts product purchases. Over 2,400 pool service professionals are members of this program.

In addition to our efforts aimed at industry and customer growth, we strive to operate more effectively by continuously focusing on improvements in our operations such as product sourcing, procurement and logistics initiatives, adoption of enhanced business practices and improved working capital management. Other key internal growth initiatives include the continued expansion of both our product offerings (as described in the “Customers and Products” section below) and our distribution networks.

We have grown our distribution networks through acquisitions, new sales center openings and expansions of existing sales centers. Since the beginning of 2006, we completed 9 acquisitions consisting of 37 sales centers (net of sales center closings and consolidations within one year of acquisition) and opened 11 new sales centers (net of all other sales center closings and consolidations). These acquired locations included nine net sales centers added ahead of the 2010 season through our General Pool & Spa Supply and Metrinox acquisitions. Given the challenging external environment, we opened only three new sales centers in 2010 and expect to open only three new sales centers in 2011.

We plan to continue to selectively expand our domestic swimming pool distribution networks and to take advantage of opportunities to further expand our domestic irrigation and international swimming pool distribution networks via both acquisitions and new sales center openings. We plan to make strategic acquisitions to further penetrate existing markets and expand into both new geographic markets and new product categories. For additional discussion of our recent acquisitions, see Note 2 of “Notes to Consolidated Financial Statements,” included in Item 8 of this Form 10-K.

Based on industry data, we believe our industry grew at a 2% to 6% annual rate for the period between 2000 and 2005, contracted each year between 2006 and 2009 and was flat to slightly up in 2010, including the impact of moderating contraction within the irrigation industry. Historically, our sales growth rates have exceeded the industry’s growth rates as we have increased our market share. We believe that our high service levels and expanded product offerings have also enabled us to gain market share during the past five years even as our industry contracted. Going forward, we expect to realize sales growth higher than the industry average due to further increases in market share and continued expansion of our product offerings.

We estimate that price inflation has averaged 1% to 3% annually in our industry over the past 10 years. We generally pass industry price increases through the supply chain and make strategic volume inventory purchases ahead of vendor price increases. In 2010, our industry experienced some price deflation after experiencing above average inflationary increases in product costs in 2008 and 2009. In 2011, we anticipate more normalized price inflation of 1% to 2% overall, although we expect price deflation for certain chemical products.

Customers and Products

We serve roughly 80,000 customers, none of which account for more than 1% of our sales. We primarily serve five types of customers:

- swimming pool remodelers and builders;
- retail swimming pool stores;
- swimming pool repair and service businesses;
- landscape construction and maintenance contractors; and
- golf courses.

The majority of these customers are small, family owned businesses with relatively limited capital resources. The recent economic environment has had the greatest impact on swimming pool remodelers and builders and landscape construction companies. We have seen a modest contraction in our customer base in these segments over the last several years.

We conduct our operations through 291 sales centers in North America and Europe. Our primary markets, which have the highest concentration of swimming pools, are California, Florida, Texas and Arizona, representing approximately 50% of our net sales in 2010. We use a combination of local and international sales and marketing personnel to promote the growth of our business and develop and strengthen our customers’ businesses. Our sales and marketing personnel focus on developing customer programs and promotional activities, creating and enhancing sales

management tools and providing product and market expertise. Our local sales personnel work from our sales centers and are charged with understanding and meeting our customers' specific needs.

We offer our customers more than 160,000 national brand and Pool Corporation branded products. We believe that our selection of pool equipment, supplies, chemicals, replacement parts, irrigation and landscape products and other pool construction and recreational products is the most comprehensive in the industry. The products we sell can be categorized as follows:

- maintenance products such as chemicals, supplies and pool accessories;
- repair and replacement parts for cleaners, filters, heaters, pumps and lights;
- packaged pool kits including walls, liners, braces and coping for in-ground and above-ground pools;
- pool equipment and components for new pool construction and the remodeling of existing pools;
- irrigation and landscape products, including professional lawn care equipment; and
- other pool construction and recreational products, which consist of a number of product categories and includes:
 - building materials used for pool installations and remodeling, such as concrete, plumbing and electrical components and pool surface and decking materials; and
 - discretionary recreational and related outdoor lifestyle products that enhance consumers' use and enjoyment of outdoor living spaces, such as pool toys and games, spas and grills.

We track and monitor the majority of our sales by various product lines and product categories, primarily for consideration in incentive plan programs and to provide support for sales and marketing efforts. We currently have over 300 product lines and over 40 product categories. Based on our 2010 product classifications, sales for our pool and spa chemicals product category as a percentage of total net sales was 14% in 2008 and 17% in both 2009 and 2010. We attribute the growth between 2008 and 2009 to increases in our market share, a shift in product mix resulting from the decline in construction related products and chemical price increases. Chemical sales growth in 2010 was consistent with our overall base business sales growth rate despite price deflation for certain chemical products. No other product category accounted for 10% or more of total net sales in any of the last three fiscal years.

We categorize our maintenance, repair and replacement products into the following two groupings:

- maintenance and minor repair (non-discretionary); and
- major repair and refurbishment (partially discretionary).

Maintenance and minor repair products are primarily non-discretionary in nature, meaning that these items must be purchased by end users to maintain existing swimming pools and landscaped areas. In 2009 and 2010, the sale of maintenance and minor repair products accounted for approximately 70% of our sales and gross profits while approximately 30% of sales and gross profits were derived from the replacement, construction and installation (equipment, materials, plumbing, electrical, etc.) of pools and landscaping. This reflects a shift toward more sales of maintenance and minor repair products due to the significant declines in new pool construction since 2005. Prior to this industry downturn, just over 50% of our total sales and gross profits were related to maintenance and minor repair products.

Since our acquisition of National Pool Tile (NPT) in 2008, we have expanded the number of sales center locations that offer NPT's tile and composite pool finish products from the original 14 locations to over 50 locations. Another key product initiative has been the expansion of our replacement parts offerings. These product initiatives, along with the continued expansion of our Pool Corporation branded products, have contributed to improved gross margins.

Other pool construction and recreational product sales have been an important factor in our historical base business sales growth. While sales of these products declined between 2007 and 2009 since the majority of these products are related to new construction activities or are discretionary by nature, sales increased in 2010 due to our ongoing expansion of these product offerings and the gradual improvement in construction and economic trends. We continue

to identify new related product categories and we typically introduce two to three of these new categories each year in certain markets. We then evaluate the performance of these test categories and focus on those that we believe exhibit long-term growth potential. We expect to realize continued sales growth for these types of product offerings by expanding the number of locations that offer these products, increasing the number of products offered at certain locations and continuing a modest broadening of these product offerings on a company-wide basis.

Operating Strategy

We distribute swimming pool supplies, equipment and related leisure products through our SCP and Superior networks and we distribute irrigation and landscape products through our Horizon network. We adopted the strategy of operating two distinct distribution networks within the swimming pool marketplace primarily for two reasons:

- to offer our customers a choice of different distributors, featuring distinctive product selections and service personnel; and
- to increase the level of customer service and operational efficiency provided by the sales centers in each network by promoting healthy competition between the two networks.

We evaluate our sales centers based upon their performance relative to predetermined standards that include both financial and operational measures. Our corporate support groups provide our field operations with various services, such as developing and coordinating customer and vendor related programs, information systems support and expert resources to help them achieve their goals. We believe our incentive programs and feedback tools, along with the competitive nature of our internal networks, stimulate and enhance employee performance.

Distribution

Our sales centers are located near customer concentrations, typically in industrial, commercial or mixed-use zones. Customers may pick up products at any sales center location, or products may be delivered via our trucks or third party carriers.

Our sales centers maintain well-stocked inventories to meet customers' immediate needs. We utilize warehouse management technology to optimize receiving, inventory control, picking, packing and shipping functions.

We also operate seven centralized shipping locations (CSLs) that redistribute products we purchase in bulk quantities to our sales centers or directly to customers. Our CSLs include regional locations that carry a wide range of traditional swimming pool, irrigation and related construction products. Our regional CSL in Florida and another CSL in California redistribute our NPT tile and composite pool finish products to sales centers that stock these products.

Purchasing and Suppliers

We enjoy good relationships with our suppliers, who generally offer competitive pricing, return policies and promotional allowances. It is customary in our industry for manufacturers to seasonally offer extended payment terms to qualifying purchasers such as POOL. These terms are typically available to us for pre-season or early season purchases.

Our preferred vendor program encourages our buyers to purchase products from a smaller number of vendors. We also work closely with our vendors to develop programs and services to better meet the needs of our customers and to concentrate our purchasing activities. These practices, together with a more comprehensive service offering, have resulted in improved margins at the sales center level.

We regularly evaluate supplier relationships and consider alternate sourcing to assure competitive cost, service and quality standards. Our largest suppliers include Pentair Water Pool and Spa, Inc., Hayward Pool Products, Inc. and Zodiac Pool Systems, Inc., which accounted for approximately 17%, 12% and 9%, respectively, of the cost of products we sold in 2010.

Competition

Based on industry knowledge and available data, management believes we are the largest wholesale distributor of swimming pool and related backyard products and the only truly national wholesale distributor focused on the swimming pool industry in the United States. We are also one of the top three distributors of landscape and irrigation products in the United States, and we compete against one national wholesale distributor of these products. We face intense competition from many regional and local distributors in our markets and to a lesser extent, mass-market retailers and large pool supply retailers with their own internal distribution networks.

Some geographic markets we serve, particularly our four largest, higher density markets in California, Florida, Texas and Arizona, are more competitive than others. Barriers to entry in our industry are relatively low. We compete with other distributors for rights to distribute brand-name products. If we lose or are unable to obtain these rights, we might be materially and adversely affected. We believe that the size of our operations allows us to compete favorably for such distribution rights.

We believe that the principal competitive factors in swimming pool and landscape supply distribution are:

- the breadth and availability of products offered;
- the quality and level of customer service;
- the breadth and depth of sales and marketing programs;
- consistency and stability of business relationships with customers;
- competitive product pricing; and
- access to commercial credit to finance business working capital.

We believe that we generally compete favorably with respect to each of these factors.

Seasonality and Weather

For a discussion regarding seasonality and weather, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Seasonality and Quarterly Fluctuations," of this Form 10-K.

Environmental, Health and Safety Regulations

Our business is subject to regulation under local fire codes and international, federal, state and local environmental and health and safety requirements, including regulation by the Environmental Protection Agency, the Consumer Product Safety Commission, the Department of Transportation, the Occupational Safety and Health Administration, the National Fire Protection Agency and the International Maritime Organization. Most of these requirements govern the packaging, labeling, handling, transportation, storage and sale of chemicals and fertilizers. We store certain types of chemicals and/or fertilizers at each of our sales centers and the storage of these items is strictly regulated by local fire codes. In addition, we sell algaecides and pest control products that are regulated as pesticides under the Federal Insecticide, Fungicide and Rodenticide Act and various state pesticide laws. These laws are primarily related to labeling, annual registration and licensing.

Employees

We employed approximately 3,200 people at December 31, 2010. Given the seasonal nature of our business, our peak employment period is the summer and depending on expected sales levels, we add 200 to 500 employees to our work force to meet seasonal demand.

Intellectual Property

We maintain both domestic and foreign registered trademarks primarily for our private label products that are important to our current and future business operations. We also own rights to several Internet domain names.

Geographic Areas

Net sales by geographic region were as follows for the past three fiscal years (in thousands):

	Year Ended December 31,		
	2010	2009	2008
United States	\$1,450,959	\$1,393,513	\$1,626,869
International	162,787	146,281	