POOL CORP
Form 10-Q
July 30, 2007

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

FORM 10-Q

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

For the quarterly period ended June 30, 2007

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)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

At July 25, 2007, there were 49,134,428 outstanding shares of the registrant's common stock, $.001 par value per share.

POOL CORPORATION
Form 10-Q
For the Quarter Ended June 30, 2007

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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 June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Net sales	**$ 726,472**	$ 705,703	**$ 1,100,178**	$ 1,054,259
Cost of sales	**518,550**	496,703	**788,771**	747,211
Gross profit	**207,922**	209,000	**311,407**	307,048
Selling and administrative expenses	**109,489**	105,662	**204,342**	188,688
Operating income	**98,433**	103,338	**107,065**	118,360
Interest expense, net	**5,897**	3,856	**10,416**	6,707
Income before income taxes and equity earnings (losses)	**92,536**	99,482	**96,649**	111,653
Provision for income taxes	**35,728**	38,410	**37,316**	43,109
Equity earnings (losses) in unconsolidated investments	**986**	1,038	**(185)**	(12)
Net income	**$ 57,794**	$ 62,110	**$ 59,148**	$ 68,532
Earnings per share:				
Basic	**$ 1.17**	$ 1.18	**$ 1.19**	$ 1.30
Diluted	**$ 1.12**	$ 1.12	**$ 1.14**	$ 1.23
Weighted average shares outstanding:				
Basic	**49,326**	52,608	**49,753**	52,602
Diluted	**51,504**	55,544	**51,974**	55,499
Cash dividends declared per common share	**$ 0.12**	$ 0.105	**$ 0.225**	$ 0.195

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

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

	June 30, 2007	June 30, 2006	December 31, 2006
Assets			
Current assets:			
Cash and cash equivalents	**$ 47,171**	$ 32,507	$ 16,734
Receivables, net	**90,892**	76,407	51,116
Receivables pledged under receivables facility	**210,373**	219,315	103,821
Product inventories, net	**388,364**	367,096	332,069
Prepaid expenses and other current assets	**10,705**	8,493	8,005
Deferred income taxes	**7,676**	4,004	7,676
Total current assets	**$ 755,181**	$ 707,822	$ 519,421
Property and equipment, net	**36,628**	30,289	33,633
Goodwill	**155,231**	142,177	154,244
Other intangible assets, net	**16,561**	17,933	18,726
Equity interest investments	**32,156**	29,882	32,509
Other assets, net	**19,065**	12,561	16,029
Total assets	**$ 1,014,822**	$ 940,664	$ 774,562
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	**229,691**	207,727	177,544
Accrued and other current liabilities	**62,071**	101,300	35,610
Short-term financing	**150,000**	150,000	74,286
Current portion of long-term debt and other long-term liabilities	**4,350**	2,850	4,350
Total current liabilities	**$ 446,112**	$ 461,877	$ 291,790
Deferred income taxes	**15,212**	14,048	15,023
Long-term debt	**272,599**	151,500	188,157
Other long-term liabilities	**6,519**	2,268	1,908
Total liabilities	**$ 740,442**	$ 629,693	$ 496,878
Stockholders' equity:			
Common stock, $.001 par value; 100,000,000 shares authorized; 49,546,774, 51,964,383 and 50,929,665 shares issued and outstanding at June 30, 2007, June 30, 2006 and December 31, 2006, respectively	**49**	51	50

Additional paid-in capital	**164,617**	137,654	148,821
Retained earnings	**102,023**	169,589	129,932
Treasury stock	**—**	—	(7,334)
Accumulated other comprehensive income	**7,691**	3,677	6,215
Total stockholders' equity	**$ 274,380**	$ 310,971	$ 277,684
Total liabilities and stockholders' equity	**$ 1,014,822**	$ 940,664	$ 774,562

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

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

	Six Months Ended June 30, 2007	2006
Operating activities		
Net income	**$ 59,148**	$ 68,532
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	**4,516**	3,833
Amortization	**2,493**	2,398
Share-based compensation	**3,945**	4,007
Excess tax benefits from share-based compensation	**(6,399)**	(9,363)
Equity losses in unconsolidated investments	**353**	25
Other	**637**	99
Changes in operating assets and liabilities, net of effects of acquisitions:		
Receivables	**(147,733)**	(153,883)
Product inventories	**(56,282)**	(37,531)
Accounts payable	**52,102**	33,541
Other current assets and liabilities	**33,145**	39,137
Net cash used in operating activities	**(54,075)**	(49,205)
Investing activities		
Acquisition of businesses, net of cash acquired	**(2,087)**	(1,446)
Purchase of property and equipment, net of sale proceeds	**(7,606)**	(7,723)
Proceeds from sale of investment	**75**	—
Net cash used in investing activities	**(9,618)**	(9,169)
Financing activities		
Proceeds from revolving line of credit	**215,271**	177,038
Payments on revolving line of credit	**(229,329)**	(153,138)
Proceeds from asset-backed financing	**87,479**	93,347
Payments on asset-backed financing	**(11,765)**	(9,004)
Proceeds from long-term debt	**100,000**	—
Payments on long-term debt and other long-term liabilities	**(1,547)**	(47)
Payments of deferred financing costs	**(397)**	(18)
Payments of capital lease obligations	**(257)**	(257)
Excess tax benefits from share-based compensation	**6,399**	9,363
Proceeds from issuance of common stock under share-based compensation plans	**5,414**	4,513
Payment of cash dividends	**(11,185)**	(10,290)
Purchase of treasury stock	**(67,998)**	(48,423)
Net cash provided by financing activities	**92,085**	63,084

Effect of exchange rate changes on cash	**2,045**	931
Change in cash and cash equivalents	**30,437**	5,641
Cash and cash equivalents at beginning of period	**16,734**	26,866
Cash and cash equivalents at end of period	**$ 47,171**	$ 32,507

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

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POOL CORPORATION
Notes to Consolidated Financial Statements
(Unaudited)

Note 1 – Summary of Significant Accounting Policies

Pool Corporation (the *Company*, which may be referred to as *POOL*, *we, us* or *our*) prepared the unaudited interim Consolidated Financial Statements following accounting principles generally accepted in the United States (GAAP) and the requirements of the Securities and Exchange Commission (SEC) for interim financial information. As permitted under those rules, certain footnotes or other financial information required by GAAP for complete financial statements have been condensed or omitted. In management's opinion, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results including the elimination of all significant intercompany accounts and transactions among our wholly owned subsidiaries.

A description of our significant accounting policies is included in our 2006 Annual Report on Form 10-K. The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and accompanying notes in our Annual Report. The results for the three and six month periods ended June 30, 2007 are not necessarily indicative of the results to be expected for the twelve months ending December 31, 2007.

On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation 48 (FIN 48), *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. See Note 6 for additional information.

Note 2 – Earnings Per Share

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

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2007	**2006**	**2007**	**2006**
Net income	**$ 57,794**	$ 62,110	**$ 59,148**	$ 68,532
Weighted average common shares outstanding:				
Basic	**49,326**	52,608	**49,753**	52,602
Effect of dilutive securities:				
Stock options	**2,129**	2,901	**2,179**	2,860
Restricted stock awards	**47**	32	**39**	31
Employee stock purchase plan	**2**	3	**3**	6
Diluted	**51,504**	55,544	**51,974**	55,499
Basic earnings per share	**$ 1.17**	$ 1.18	**$ 1.19**	**$** 1.30

Diluted earnings per share	**$ 1.12**	$ 1.12	**$ 1.14**	**$** 1.23

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POOL CORPORATION
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

The weighted average diluted shares outstanding for the three and six months ended June 30, 2007 exclude stock options to purchase 580,050 shares. Since these options have exercise prices that are higher than the average market price of our common stock, including them in the calculation would have an anti-dilutive effect on earnings per share for the respective periods. There were no anti-dilutive stock options excluded from the earnings per share calculation for the three and six months ended June 30, 2006.

Note 3 – Comprehensive Income

Comprehensive income includes net income, foreign currency translation adjustments and the unrealized gain or loss on interest rate swaps. Comprehensive income for the three and six months ended June 30, 2007 and 2006 are presented below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Comprehensive income	**$ 59,985**	$ 63,064	**$ 60,624**	$ 70,070

Note 4 – Acquisitions

As discussed in Note 2 of "Notes to Consolidated Financial Statements" included in Item 8 of our 2006 Annual Report on Form 10-K, in August 2006 we acquired Wickham Supply, Inc. and Water Zone, LP (collectively Wickham), a leading regional irrigation products distributor. Wickham operates 14 distribution sales centers with 13 locations throughout Texas and one location in Georgia. We have included the results of operations for Wickham in our Consolidated Financial Statements since the acquisition date.

In February 2007, we acquired Tor-Lyn Limited, a swimming pool supply distributor with one sales center location in Ontario, Canada. We have included the results of operations for Tor-Lyn Limited in our Consolidated Financial Statements since the acquisition date. This acquisition did not have a material impact on our financial position or results of operations.

Note 5 – Debt

On February 12, 2007, we issued and sold $100.0 million aggregate principal amount of Floating Rate Senior Notes (the Notes) in a private placement offering pursuant to a Note Purchase Agreement. The Notes are due February 12, 2012 and will accrue interest on the unpaid principal balance at a floating rate equal to a spread of 0.600% over the three-month LIBOR, as adjusted from time to time. The Notes have scheduled quarterly interest payments that are due on February 12, May 12, August 12 and November 12 of each year. The Notes are unsecured and are guaranteed by each domestic subsidiary that is or becomes a borrower or guarantor under our unsecured syndicated senior credit facility. We used the net proceeds from the placement to pay down borrowings under our revolving credit facility.

The Notes are subject to redemption at our option, in whole or in part, at 103% of the principal amount on or prior to February 12, 2008 and at 100% of the principal amount thereafter, plus accrued interest to the date of redemption and any LIBOR breakage amount as defined by the Note Purchase Agreement. In the event we have a change of control, the holders of the Notes will have the right to put the Notes back to us at par.

In February 2007, we also entered into an interest rate swap agreement to reduce our exposure to fluctuations in interest rates on the Notes. The swap agreement converts the variable interest rate to a fixed rate of 5.088% on the initial notional amount of $100.0 million, which will decrease to a notional amount of $50.0 million in 2010. Any difference paid or received on the interest rate swap will be recognized as an adjustment to interest expense over the life of the swap. We record the changes in the fair value of the swap to accumulated other comprehensive income. We have designated this swap as a cash flow hedge. The swap agreement will terminate on February 12, 2012. Including the 0.600% spread, we expect to pay an effective interest rate on the Notes of approximately 5.688%.

Note 6 – Income Taxes

As discussed in Note 1, we adopted FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, we recognized a reduction of approximately $0.5 million to the January 1, 2007 retained earnings balance. At January 1, 2007, the total amount of gross unrecognized tax benefits was approximately $3.3 million. This amount includes approximately $2.2 million of unrecognized tax benefits, which would decrease our effective tax rate if recognized at some point in the future.

Effective January 1, 2007, in connection with the adoption of FIN 48, we changed our accounting policy and now recognize accrued interest related to unrecognized tax benefits in interest expense and recognize penalties in selling and administrative expenses. These amounts were previously classified as a component of income tax expense. The accrued interest balance related to unrecognized tax benefits was approximately $0.4 million at January 1, 2007.

As a result of tax positions taken in the current periods, we recorded an increase in gross unrecognized tax benefits of approximately $0.6 million in the second quarter of 2007. For the six months ended June 30, 2007, the increase totaled $0.7 million. Also in the second quarter, we recorded an increase of approximately $0.5 million in unrecognized tax benefits that could impact our effective tax rate, making the year to date increase $0.6 million. The accrued interest balance related to unrecognized tax benefits was approximately $0.6 million at June 30, 2007.

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 2003. We anticipate that the accounting under the provisions of FIN 48 may provide for greater volatility in our effective tax rate as items are derecognized or as we record changes in measurement in interim periods.

Note 7 – Share-Based Compensation Plans

In May 2007, our shareholders approved the 2007 Long-Term Incentive Plan (the 2007 LTIP), which authorizes the Compensation Committee of our Board of Directors (our Board) to grant non-qualified stock options and restricted stock to employees, directors, consultants or advisors. No more than 1,515,000 shares may be issued under this plan. Granted stock options have an exercise price equal to our stock's closing market price on the date of grant. These options generally vest either five years from the grant date or on a three/five year split vest schedule, where half of the options vest three years from the grant date and the remainder vest five years from the grant date. These options expire ten years from the grant date. Restricted stock awarded under the 2007 LTIP is issued at no cost to the grantee and is subject to vesting restrictions. The restricted stock awards generally vest either one year from the grant date for awards to directors or five years from the grant date for all other awards.

The 2007 LTIP has replaced the 2002 Long-Term Incentive Plan, which has been suspended by the Board, and the SCP Pool Corporation Non-Employee Directors Equity Incentive Plan, which expired in 2006. No additional awards will be granted under these predecessor plans.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with Management's Discussion and Analysis included in our 2006 Annual Report on Form 10-K.

OVERVIEW

Financial Results

Net sales grew 3% to $726.5 million in the second quarter of 2007 compared to $705.7 million in 2006. The increase is attributable to acquired sales centers, primarily the Wickham business acquired in August 2006, base business sales growth of approximately 1% (on top of 13% growth in the second quarter of 2006) and new sales centers opened in new markets. Our sales were negatively impacted by a difficult combination of external conditions, including the depressed housing and real estate markets and the record wet weather in Texas and Oklahoma.

Our base business sales growth continues to reflect the growth in the installed base of swimming pools and market share gains through the execution of sales, marketing and service programs that we offer to our customers. Complementary product sales increased 9% during the second quarter compared to 23% growth for the same period in 2006.

Our gross profit as a percentage of net sales (gross margin) decreased 100 basis points to 28.6% in the second quarter of 2007 from the second quarter of 2006. This decrease reflects the impact of competitive pricing pressures resulting from the current market environment, the impact of early buy and early pay inventory purchases in the fourth quarter of 2005 and the timing of vendor incentives recorded in 2006, which both benefited gross margin for the first half of 2006.

Selling and administrative expenses (operating expenses) increased 4% in the second quarter of 2007 compared to the second quarter of 2006. This increase includes the impact from investments in new sales centers since the beginning of 2006, the addition of expenses from the Wickham acquisition in August 2006, higher expenses related to sales center expansions and relocations within the past year and investments in other business development initiatives. These higher expenses were partially offset by lower incentive compensation and the impact from cost control initiatives. Base business operating expenses were flat and consistent as a percentage of sales quarter over quarter.

Our operating income decreased 5% to $98.4 million in the second quarter of 2007 while operating margin decreased to 13.5% of sales from 14.6% in the second quarter of 2006. Interest expense increased 53% for the second quarter of 2007 due to higher debt levels for borrowings to fund share repurchases and a higher average effective interest rate compared to the same period in 2006. Net income decreased 7% to $57.8 million compared to the second quarter of 2006 and included $1.0 million of net equity earnings from our investment in Latham Acquisition Corporation (LAC).

Financial Position and Liquidity

Accounts receivable increased $5.6 million to $301.3 million at June 30, 2007 from $295.7 million at June 30, 2006. Our allowance for doubtful accounts balance was $6.4 million at June 30, 2007, an increase of $2.2 million over June 30, 2006 due primarily to a slowdown in customer payments in some of the more competitive markets. Days sales outstanding (DSO) increased between periods to 35.8 days at June 30, 2007 compared to 34.0 days at June 30, 2006 as a result of the addition of Horizon's and Wickham's receivables, which have slightly longer collection cycles. Excluding Horizon and Wickham, DSO increased slightly to 33.4 days compared to 32.8 days at June 30, 2006.

Our inventory levels increased 6% to $388.4 million as of June 30, 2007, compared to June 30, 2006. This increase includes inventory related to the Wickham acquisition and new sales centers. Our inventory turns, as calculated on a trailing twelve month basis, have decreased slightly to 3.9 times as of June 30, 2007 from 4.0 times as of June 30, 2006.

Total debt outstanding increased 41% to $425.6 million at June 30, 2007 compared to $303.0 million at June 30, 2006. This increase is attributable to increased borrowings to fund share repurchases of approximately $127.0 million over the past 12 months and the Wickham acquisition. We continue to maintain a healthy current ratio, which increased to 1.7 as of June 30, 2007 compared to 1.5 as of June 30, 2006.

Current Trends

Current economic trends include a slowdown in the domestic housing market, with lower housing turnover, a sharp drop in new home construction, home value deflation in some markets, increases in short-term interest rates and a tightening of credit in the sub-prime lending market. Some of the factors that mitigate the impact of these trends on our business include the following:

- the majority of our business is driven by recurring sales related to the ongoing maintenance and repair of existing pools and landscaped areas, with less than 40% of our sales tied to new pool or irrigation construction;
- we estimate that only 10% to 20% of new pools are constructed along with new home construction; and
- we have a low market share with the largest pool builders who we believe are more heavily tied to new home construction.

Despite these mitigating factors, these negative trends had a more pronounced impact during the second quarter of 2007 and have significantly impacted some of our key markets, including Florida, Arizona and parts of California. We believe these trends, along with the impact of unusually wet weather in Texas and Oklahoma and a delay in the start of pool construction in northern markets due to unfavorable weather conditions in the first quarter, will likely result in a 10% to 20% decrease in new pool construction in 2007 compared to 2006. A more severe and/or prolonged housing market slowdown and continuing adverse weather may have a greater impact on new pool construction that could negatively impact our current sales and earnings projections.

Outlook

In July, we updated our 2007 earnings per share guidance to $1.75 to $1.85 per diluted share to reflect our second quarter results and our more cautious outlook for the remainder of the year. We still expect to realize more sales growth relative to 2006 in the second half of the year based on easier sales comparisons, but now anticipate modest single digit sales growth for the full year 2007, with mid-single digit sales growth in the second half of 2007.

Based on the current market environment with some competitors being very aggressive on pricing, we believe that gross margin in the third quarter of 2007 will be lower than in the third quarter of 2006. However, we expect that our fourth quarter 2007 gross margin will be marginally higher than the fourth quarter 2006 gross margin, which was adversely impacted by our 2006 year end vendor incentive adjustment. Overall, we expect a decline in gross margin of 30 to 50 basis points in the second half of 2007 compared to the second half of 2006. We expect cash flow from operations for the year to be between $70.0 and $80.0 million.

Our business is subject to significant risks, including weather, competition, general economic conditions and other risks detailed in Part II - Item 1A. “Risk Factors” and our “Cautionary Statement for Purpose of the ‘Safe Harbor’ Provisions of the Private Securities Litigation Reform Act of 1995”.

RESULTS OF OPERATIONS

As of June 30, 2007, we conducted operations through 283 sales centers in North America and Europe.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Net sales	**100.0%**	100.0%	**100.0%**	100.0%
Cost of sales	**71.4**	70.4	**71.7**	70.9
Gross profit	**28.6**	29.6	**28.3**	29.1
Selling and administrative expenses	**15.1**	15.0	**18.6**	17.9
Operating income	**13.5**	14.6	**9.7**	11.2
Interest expense	**0.8**	0.5	**0.9**	0.6
Income before income taxes and equity earnings (losses)	**12.7%**	14.1%	**8.8%**	10.6%

The following discussion of consolidated operating results includes the operating results from acquisitions in 2007, 2006 and 2005. We accounted for these acquisitions using the purchase method of accounting, and we have included the results of operations in our consolidated results since the respective acquisition dates.

We exclude the following sales centers from base business for 15 months:

- acquired sales centers;
- sales centers divested or consolidated with acquired sales centers; and
- sales centers opened in new markets.

Additionally, we generally allocate overhead expenses to acquired sales centers on the basis of acquired sales center net sales as a percentage of total net sales.

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

(Unaudited)	Base Business		Acquired & New Market		Total	
(In thousands)	Three Months Ended June 30,		Three Months Ended June 30,		Three Months Ended June 30,	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Net sales	**$707,835**	$704,264	**$18,637**	$ 1,439	**$726,472**	$705,703
Gross profit	**202,440**	208,603	**5,482**	397	**207,922**	209,000
Gross margin	**28.6%**	29.6%	**29.4%**	27.6%	**28.6%**	29.6%
Selling and administrative expenses	**105,531**	105,175	**3,958**	487	**109,489**	105,662
	14.9%	14.9%	**21.2%**	33.8%	**15.1%**	15.0%

Expenses as a % of net sales						
Operating income (loss)	**96,909**	103,428	**1,524**	(90)	**98,433**	103,338
Operating income (loss) margin	**13.7%**	14.7%	**8.2%**	(6.3)%	**13.5%**	14.6%

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For purposes of comparing operating results for the three months ended June 30, 2007 to the three months ended June 30, 2006, 263 sales centers were included in the base business calculations (including 20 of the 25 new sales centers opened since the beginning of 2006) and 20 sales centers were excluded because they were acquired or opened in new markets within the last 15 months. The effect of sales center acquisitions in the table above reflects the operations of the following:

Acquired	Acquisition Date	Sales Centers Acquired	Period Excluded (1)
Wickham Supply, Inc. and Water Zone, LP	August 2006	14	April – June 2007
Tor-Lyn, Limited	February 2007	1	April – June 2007

(1) After 15 months of operations, we include acquired sales centers in the base business calculation including the comparative prior year period.

Net Sales

(in millions)	Three Months Ended June 30, 2007	2006	Change	
Net sales	**$ 726.5**	$ 705.7	$ 20.8	3%

The increase in net sales is a result of our recent acquisitions, approximately 1% base business growth and sales from new locations that we opened in new markets. Our sales were negatively impacted by the prolonged domestic housing market downturn and adverse weather conditions in Texas and Oklahoma. Base business sales were up moderately in April and May, but down roughly 6% in June compared to the same periods in 2006.

The base business growth in the second quarter of 2007 was primarily due to the following:

- the continued successful execution of our sales, marketing and service programs, resulting in market share gains;
- a larger installed base of swimming pools resulting in increased sales of non-discretionary products;
- complementary product sales growth of approximately 9%; and
- price increases, which we passed through the supply chain.

These positive impacts on our base business sales have helped offset base business sales decreases in some of our larger markets, including Florida, Arizona and parts of California, which have been impacted by significant declines in new pool construction permits. Our second quarter sales reflect similar patterns at the product category level, with solid sales growth for chemicals and certain construction materials used in remodeling and new construction and decreases for categories such as pipe that are used almost exclusively in new construction.

Gross Profit

(in millions)	Three Months Ended June 30, 2007	2006	Change	
Gross profit	**$ 207.9**	$ 209.0	$ (1.1)	(1)%
Gross margin	**28.6%**	29.6%		

Gross margin decreased 100 basis points between periods, including a 100 basis point decline in base business gross margin. Our second quarter 2007 gross margin is comparatively lower primarily due to competitive pricing pressures experienced in the current market environment and unfavorable comparisons to the second quarter 2006 gross margin, which had increased 80 basis points over the second quarter 2005. The combined impacts of early buy and early pay inventory purchases in the fourth quarter of 2005 and the timing of vendor incentives recorded in 2006 benefited first half 2006 gross margin. Our gross margin in the second quarter of 2007 reflects a lower vendor incentive rate compared to the second quarter of 2006, which did not include the impact of changes in our estimates for earned vendor incentives that were recorded as cumulative catch-up adjustments in the third and fourth quarters of 2006. These decreases were partially offset by gross margin improvements attributable to certain price increases and slightly higher margin contribution from acquired sales centers.

Operating Expenses

	Three Months Ended June 30,			
(in millions)	**2007**	**2006**	**Change**	
Operating expenses	**$ 109.5**	$ 105.7	$ 3.8	4%
Operating expenses as a percentage of net sales	**15.1%**	15.0%		

Compared to the second quarter of 2006, operating expenses grew 4% and increased 10 basis points as a percentage of net sales while base business operating expenses were flat for the second quarter of 2007 and were consistent as a percentage of sales quarter over quarter. This increase includes incremental expenses for the 25 new sales centers that we have opened since the beginning of 2006, operating expenses from the Wickham acquisition, higher rent expenses related to our expansion or relocation of over 30 existing sales centers over the past 15 months and additional expenses for our investments in resources related to other growth initiatives. These expenses were partially offset by lower incentive compensation and the impact from cost control initiatives.

Interest Expense

Interest expense increased $2.0 million between periods due to a 44% increase in the average debt outstanding compared to the second quarter of 2006 and an increase in the effective interest rate to 5.9% in 2007 from 5.6% in 2006.

Income Taxes

The decrease in income taxes is due to the $7.0 million decrease in income before income taxes and equity earnings. Our effective income tax rate was 38.6% for the three months ended June 30, 2007 and June 30, 2006.

Net Income and Earnings Per Share

Net income decreased 7% to $57.8 million in the second quarter of 2007 from $62.1 million in the second quarter of 2006. Net income included $1.0 million of net equity earnings from our investment in LAC in both the second quarter of 2007 and the second quarter of 2006. Diluted earnings per share remained unchanged at $1.12 per share for the second quarter of 2007 and the second quarter of 2006.

Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

(Unaudited) (In thousands)	Base Business Six Months Ended June 30,		Acquired & New Market Six Months Ended June 30,		Total Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Net sales	**$1,068,154**	$1,052,473	**$32,024**	$ 1,786	**$1,100,178**	$1,054,259
Gross profit	**302,079**	306,589	**9,328**	459	**311,407**	307,048
Gross margin	**28.3%**	29.1%	**29.1%**	25.7%	**28.3%**	29.1%
Selling and administrative expenses	**197,255**	187,818	**7,087**	870	**204,342**	188,688
Expenses as a % of net sales	**18.5%**	17.8%	**22.1%**	48.7%	**18.6%**	17.9%
Operating income (loss)	**104,824**	118,771	**2,241**	(411)	**107,065**	118,360
Operating income (loss) margin	**9.8%**	11.3%	**7.0%**	(23.0)%	**9.7%**	11.2%

For purposes of comparing operating results for the six months ended June 30, 2007 to the six months ended June 30, 2006, 263 sales centers were included in the base business calculations (including 20 of the 25 new sales centers opened since the beginning of 2006) and 20 sales centers were excluded because they were acquired or opened in new markets within the last 15 months. The effect of sales center acquisitions in the table above reflects the operations of the following:

Acquired	**Acquisition Date**	**Sales Centers Acquired**	**Period Excluded** [(1)]
Wickham Supply, Inc. and Water Zone, LP	August 2006	14	January – June 2007
Tor-Lyn, Limited	February 2007	1	February – June 2007

(1) After 15 months of operations, we include acquired sales centers in the base business calculation including the comparative prior year period.

Net Sales

(in millions)	Six Months Ended June 30, 2007	2006	Change	
Net sales	**$ 1,100.2**	$ 1,054.3	$ 45.9	4%

The increase in net sales is a result of approximately 2% base business growth, the Wickham acquisition and sales from new locations that we opened in new markets. Our sales were negatively impacted by unfavorable weather conditions including significantly colder temperatures in the early part of 2007, late winter storms and extended winter conditions that delayed the start of the pool season in northern markets and unfavorable weather conditions in Texas and Oklahoma for much of the second quarter of 2007. Our sales were also negatively impacted by the prolonged domestic housing market downturn.

The base business growth in the first six months of 2007 was primarily due to the following:

- the continued successful execution of our sales, marketing and service programs, resulting in market share gains;
- a larger installed base of swimming pools resulting in increased sales of non-discretionary products;
- price increases, primarily the mid-year 2006 inflationary increases which we passed through the supply chain; and
- a 2% increase in complementary product sales.

Gross Profit

	Six Months Ended June 30,			
(in millions)	2007	2006	Change	
Gross profit	$ 311.4	$ 307.0	$ 4.4	1%
Gross margin	28.3%	29.1%		

Gross margin decreased 80 basis points between periods, including a consistent decline in base business gross margin. Our 2007 gross margin is comparatively lower primarily due to the impacts of early buy inventory purchases and discounts for early payments on those purchases in the fourth quarter of 2005, which benefited our 2006 gross margin. Our gross margin also reflects a lower estimated vendor incentive rate compared to the first half of 2006. These decreases were partially offset by gross margin improvements attributable to certain price increases and slightly higher margin contribution from acquired sales centers.

Operating Expenses

	Six Months Ended June 30,			
(in millions)	2007	2006	Change	
Operating expenses	$ 204.3	$ 188.7	$ 15.6	8%
Operating expenses as a percentage of net sales	18.6 %	17.9%		

Compared to the first half of 2006, operating expenses grew 8% and increased 70 basis points as a percentage of net sales. Base business operating expenses were 5% higher in the first half of 2007 compared to the same period in 2006 and increased 70 basis points as a percentage of sales. This increase includes incremental expenses for the 25 new sales centers that we have opened since the beginning of 2006, higher rent expenses related to our expansion or relocation of sales centers and additional expenses for our investments in resources related to other growth initiatives. These increased costs were partially offset by lower incentive expenses in the first half of 2007 compared to 2006 and cost control initiatives.

We opened 8 new sales centers in the first half of 2007 compared to twelve sales centers in the first half of 2006.

Interest Expense

Interest expense increased $3.7 million between periods as average debt outstanding was 42% higher in the first six months of 2007 compared to the first six months of 2006 and the effective interest rate increased to 5.9% in 2007 from 5.4% in 2006.

Income Taxes

The decrease in income taxes is due to the $15.0 million decrease in income before income taxes and equity losses. Our effective income tax rate was 38.6% for the six months ended June 30, 2007 and June 30, 2006.

Net Income and Earnings Per Share

Net income decreased 14% to $59.1 million in the first six months of 2007 from $68.5 million in the first six months of 2006. Our equity interest in LAC produced a small loss in the first six months of 2007. For the year, we expect a positive contribution to our earnings from LAC. Earnings per share for the first six months of 2007 decreased 7% to $1.14 per diluted share compared to $1.23 in the first six months of 2006.

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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 installations and maintenance. Sales are substantially lower during the first and fourth quarters when we may incur net losses.

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 and second quarters of 2007, the four quarters of 2006 and the third and fourth quarters of 2005. 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 an accurate indication of results for an entire fiscal year or of continuing trends.

(Unaudited)	QUARTER							
(in thousands)	**2007**		**2006**				**2005** [1]	
	Second	**First**	**Fourth**	**Third**	**Second**	**First**	**Fourth**	**Third**
Statement of Income Data								
Net sales	**$726,472**	$						