

DXP ENTERPRISES INC

Form 10-Q

August 09, 2012

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

Form 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the quarterly period ended June 30, 2012

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 0-21513  
DXP Enterprises, Inc.  
(Exact name of registrant as specified in its charter)

Texas	76-0509661
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
7272 Pinemont, Houston, Texas 77040	(713) 996-4700
(Address of principal executive offices)	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 Regulation 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, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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 Exchange Act). Yes ☐ No ☒

Number of shares of registrant's Common Stock outstanding as of August 8, 2012: 14,168,086.

## PART I: FINANCIAL INFORMATION

## ITEM 1: FINANCIAL STATEMENTS

DXP ENTERPRISES, INC., AND SUBSIDIARIES UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS (In Thousands, Except Share and Per Share Amounts)		
	June 30, 2012 (unaudited)	December 31, 2011 (unaudited)
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash	\$ 6,591	\$ 1,507
Trade accounts receivable, net of allowances for doubtful accounts of \$6,879 in 2012 and \$6,202 in 2011	157,781	137,024
Inventories, net	99,389	93,901
Prepaid expenses and other current assets	3,279	2,230
Deferred income taxes	5,219	4,539
Total current assets	272,259	239,201
Property and equipment, net	27,972	16,911
Goodwill	119,844	101,764
Other intangibles, net of accumulated amortization of \$30,965 in 2012 and \$26,175 in 2011	55,766	43,194
Non-current deferred income taxes	-	1,588
Other assets	2,372	2,680
Total assets	\$ 478,213	\$ 405,338

LIABILITIES		
AND		
SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 3,127	\$ 694
Trade accounts payable	75,521	62,123
Outstanding checks related to acquisition	-	36,697
Accrued wages and benefits	13,084	12,713
Customer advances	8,507	3,767
Federal income taxes payable	986	2,409
Other accrued liabilities	12,956	16,055
Total current liabilities	114,181	134,458
Long-term debt, less current portion	178,154	114,205
Non-current deferred income taxes	4,190	-
Shareholders' equity:		
Series A preferred stock, 1/10th vote per share; \$1.00 par value;		
liquidation preference of \$100 per share (\$112 at June 30, 2012);		
1,000,000 shares authorized; 1,122 shares issued and outstanding		
	1	1
Series B convertible preferred stock, 1/10th vote per share; \$1.00 par value; \$100 stated value; liquidation preference of \$100 per	15	15

share (\$1,500 at J u n e 3 0 , 2012); 1,000,000 shares authorized; 15,000 shares i s s u e d a n d outstanding		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 14,234,210 in 2 0 1 2 a n d 14,183,391 in 2011		
shares issued	142	141
Paid-in capital	77,223	75,204
Retained earnings	106,473	82,695
Accumulated other c o m p r e h e n s i v e (loss) income	(334)	64
Treasury stock, at cost (75,471 shares at June 30, 2012 and 65,171 shares at December 31, 2011)	(1,832)	(1,445)
T o t a l shareholders' equity	181,688	156,675
Total liabilities and shareholders' equity	\$ 478,213	\$ 405,338
See notes to unaudited condensed consolidated financial statements.		

DXP ENTERPRISES, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
AND COMPREHENSIVE INCOME  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Sales	\$ 261,894	\$ 197,675	\$ 514,181	\$ 380,762
Cost of sales	185,265	140,410	366,078	271,070
Gross profit	76,629	57,265	148,103	109,692

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Selling, general and administrative expense	55,782	43,634	107,351	84,519
Operating income	20,847	13,631	40,752	25,173
Other income	(3)	15	12	36
Interest expense	(762)	(1,023)	(1,591)	(2,045)
Income before income taxes	20,082	12,623	39,173	23,164
Provision for income taxes	7,905	5,013	15,350	9,211
Net income	12,177	7,610	23,823	13,953
Preferred stock dividend	(22)	(22)	(45)	(45)
Net income attributable to common shareholders	\$ 12,155	\$ 7,588	\$ 23,778	\$ 13,908
Net income	\$ 12,177	\$ 7,610	\$ 23,823	\$ 13,953
Loss on long-term investment, net of income taxes	(52)	-	(281)	-
Loss on foreign currency valuation, net of income taxes	(117)	-	(117)	-
Comprehensive income	\$ 12,008	\$ 7,610	\$ 23,425	\$ 13,953
Basic income per share	\$ 0.84	\$ 0.53	\$ 1.66	\$ 0.97
Weighted average common shares outstanding	14,392	14,327	14,360	14,303
Diluted income per share	\$ 0.80	\$ 0.50	\$ 1.57	\$ 0.92
Weighted average common and common equivalent shares outstanding	15,232	15,167	15,200	15,143

See notes to unaudited condensed consolidated financial statements.

DXP ENTERPRISES, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

SIX MONTHS ENDED			
JUNE 30			
	2012		2011
	(unaudited)		(unaudited)
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 23,823	\$	13,953
Adjustments to reconcile net income to net cash provided by operating activities – net of acquisitions and divestitures			
Depreciation	2,019		1,732
Amortization of intangibles	4,790		3,210
Compensation expense for restricted stock	954		601
Tax benefit related to vesting of restricted stock	(248)		(97)
Deferred income taxes	(298)		1,908
Changes in operating assets and liabilities, net of assets and liabilities acquired in business combinations:			
Trade accounts receivable	(10,954)		(14,944)
Inventories	(3,387)		(1,775)
Prepaid expenses and	(468)		(1,479)

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other current assets		
Accounts payable and accrued expenses	8,677	13,161
Net cash (used in) provided by operating activities	24,908	16,270

# CASH FLOWS FROM INVESTING ACTIVITIES:

Purchase of property and equipment	(9,981)	(2,631)
Purchase of businesses, net of cash acquired	(73,485)	-
Net cash used in investing activities	(83,466)	(2,631)

# CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from debt	101,178	104,135
Principal payments on revolving line of credit and other long-term debt	(37,352)	(117,456)
Dividends paid in cash	(45)	(45)
Purchase of treasury stock	(387)	-
Tax benefit related to vesting of restricted stock	248	97
Net cash provided by (used) in financing activities	63,642	(13,269)



INCREASE IN CASH	5,084	370
CASH AT BEGINNING OF PERIOD	1,507	770
CASH AT END \$ OF PERIOD	6,591 \$	1,140

Purchase of businesses in 2012 include \$36.7 million which represented outstanding checks at December 31, 2011, related to an acquisition in 2011.

See notes to unaudited condensed consolidated financial statements.

## DXP ENTERPRISES INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. DXP Enterprises, Inc. (together with its subsidiaries, the "Company" or "DXP") believes that the presentations and disclosures herein are adequate to make the information not misleading. The condensed consolidated financial statements reflect all elimination entries and adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the interim periods.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission ("SEC").

#### NOTE 2: THE COMPANY

DXP Enterprises, Inc., a Texas corporation, was incorporated on July 26, 1996, to be the successor to SEPCO Industries, Inc. DXP Enterprises, Inc. and its subsidiaries are engaged in the business of distributing maintenance, repair and operating ("MRO") products, equipment and service to industrial customers. The Company is organized into three segments: Service Centers, Supply Chain Services ("SCS") and Innovative Pumping Solutions ("IPS"). See Note 8 for discussion of the business segments.

#### NOTE 3: RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board ("FASB") issued an amendment to the fair value measurement guidance and disclosure requirements. The new requirements were effective for the first interim or

annual period beginning after December 15, 2011 and were to be applied prospectively. DXP adopted the new requirements in the first quarter of 2012; however, the adoption of this guidance did not have a material effect on its consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued an amendment to the requirements for presenting comprehensive income. The new requirements were effective for the first interim or annual period beginning after December 15, 2011 and were to be applied retrospectively. The standard requires other comprehensive income to be presented in a continuous statement of comprehensive income that would combine the components of net income and other comprehensive income, or in a separate, but consecutive, statement following the statement of income. DXP elected to early adopt these new requirements effective December 31, 2011.

In September 2010, the FASB issued an accounting standards update with new guidance on annual goodwill impairment testing. The standards update allows an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If based on its qualitative assessment an entity concludes it is more likely than not that the fair value of a reporting unit is less than its carrying amount, quantitative impairment testing is required. However, if an entity concludes otherwise, quantitative impairment testing is not required. The standards update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. DXP elected to early adopt these new requirements effective December 31, 2011.

#### NOTE 4: STOCK-BASED COMPENSATION

##### Restricted Stock.

Under the restricted stock plan approved by our shareholders in July 2005 (the “Restricted Stock Plan”), directors, consultants and employees may be awarded shares of DXP’s common stock. The shares of restricted stock granted to employees and that are outstanding as of June 30, 2012 vest in accordance with one of the following vesting schedules: 100% one year after date of grant; 33.3% each year for three years after date of grant; 20% each year for five years after the grant date; or 10% each year for ten years after the grant date. The Restricted Stock Plan provides that on each July 1 during the term of the plan each non-employee director of DXP will be granted the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on such July 1. The shares of restricted stock granted to non-employee directors of DXP vest one year after the grant date. The fair value of restricted stock awards is measured based upon the closing prices of DXP’s common stock on the grant dates and is recognized as compensation expense over the vesting period of the awards.

The following table provides certain information regarding the shares authorized and outstanding under the Restricted Stock Plan at June 30, 2012:

Number of shares authorized for grants	800,000
Number of shares granted	(648,450)
Number of shares forfeited	64,947
Number of shares available for future grants	216,497
Weighted-average grant price of	\$18.35

## granted shares

Changes in restricted stock for the six months ended June 30, 2012 were as follows:

	Number of Shares	Weighted Average Grant Price
Non-vested at December 31, 2011	228,592	\$21.10
Granted	36,496	\$37.78
Forfeited	4,209	\$21.06
Vested	30,690	\$17.64
Non-vested at June 30, 2012	230,189	\$24.21

Compensation expense, associated with restricted stock, recognized in the six months ended June 30, 2012 and 2011 was \$954,000 and \$601,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$4,477,000 and \$4,051,000 at June 30, 2012 and December 31, 2011, respectively. As of June 30, 2012, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 30 months.

## NOTE 5: INVENTORY

The carrying values of inventories are as follows (in thousands):

	June 30, 2012	December 31, 2011
Finished goods	\$106,263	\$ 102,645
Work in process	7,253	5,246
Obsolescence reserve	(14,127)	(13,990)
Inventories	\$ 99,389	\$ 93,901

## NOTE 6: GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill and other intangibles during the six months ended June 30, 2012 are as follows (in thousands):

	Total	Goodwill	Other Intangibles
Balance as of December	\$ 144,958	\$ 101,764	\$ 43,194

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31, 2011			
Acquired during the year	35,442	18,130	17,312
Adjustments to prior year estimates	-	(50)	50
Amortization	(4,790)	-	(4,790)
Balance as of June 30, 2012	\$ 175,610	\$ 119,844	\$ 55,766

A summary of amortizable other intangible assets follows (in thousands):

	As of June 30, 2012		As of December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Vendor agreements	\$ 2,496	\$ (1,018)	\$ 2,496	\$ (956)
Customer relationships	81,022	(28,078)	64,262	(23,508)
Non-compete agreements	3,213	(1,869)	2,611	(1,711)
Total	\$ 86,731	\$ (30,965)	\$ 69,369	\$ (26,175)

Other intangible assets are generally amortized on a straight line basis over the useful lives of the assets.

NOTE 7. EARNINGS PER SHARE DATA

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated.

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Basic:				
Weighted average shares outstanding	14,392,145	14,327,266	14,360,246	14,303,209
Net income	\$ 12,177,000	\$ 7,610,000	\$ 23,823,000	\$ 13,953,000
Convertible preferred stock dividend	(22,000)	(22,000)	(45,000)	(45,000)
Net income attributable to common shareholders	\$ 12,155,000	\$ 7,588,000	\$ 23,778,000	\$ 13,908,000

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Per share amount	\$	0.84	\$	0.53	\$	1.66	\$	0.97
Diluted:								
Weighted average shares outstanding		14,392,145		14,327,266		14,360,246		14,303,209
Assumed conversion of convertible preferred stock		840,000		840,000		840,000		840,000
Total		15,232,145		15,167,266		15,200,246		15,143,209
Net income attributable to common shareholders	\$	12,155,000	\$	7,588,000	\$	23,778,000	\$	13,908,000
Convertible preferred stock dividend		22,000		22,000		45,000		45,000
Net income for diluted earnings per share	\$	12,177,000	\$	7,610,000	\$	23,823,000	\$	13,953,000
Per share amount	\$	0.80	\$	0.50	\$	1.57	\$	0.92

NOTE 8: SEGMENT REPORTING

The Service Centers segment is engaged in providing maintenance, repair and operating products, equipment and integrated services, including logistics capabilities, to industrial customers. The Service Centers segment provides a wide range of MRO products in the rotating equipment, bearing, power transmission, hose, fluid power, metal working, fastener, industrial supply, safety products and safety services categories. The Innovative Pumping Solutions segment fabricates and assembles custom-made engineered pump packages. The Supply Chain Services segment manages all or part of a customer's supply chain, including inventories.

The high degree of integration of the Company's operations necessitates the use of a substantial number of allocations and apportionments in the determination of business segment information. Sales are shown net of intersegment eliminations. All business segments operate primarily in the United States.

Financial information relating the Company's segments is as follows (in thousands):

Three Months ended June 30,			Six Months ended June 30,		
Service	Innovative	Supply	Service	Innovative	Supply

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	Centers	Pumping Solutions	Chain Services	Total	Centers	Pumping Solutions	Chain Services	Total
2012								
Sales	\$ 184,106	\$ 35,177	\$ 42,611	\$ 261,894	\$ 359,178	\$ 74,612	\$ 80,391	\$ 514,181
Operating income for reportable segments	22,491	6,939	3,902	33,332	41,045	15,187	6,719	62,951
2011								
Sales	\$ 139,503	\$ 21,814	\$ 36,358	\$ 197,675	\$ 271,054	\$ 38,499	\$ 71,209	\$ 380,762
Operating income for reportable segments	17,340	3,085	2,136	22,561	32,121	5,943	4,050	42,114

A reconciliation of operating income for reportable segments to the consolidated income before taxes is as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Operating income for reportable segments	\$ 33,332	\$ 22,561	\$ 62,951	\$ 42,114
Adjustment for:				
Amortization of intangibles	2,556	1,604	4,790	3,210
Corporate and other expense, net	9,929	7,326	17,409	13,731
T o t a l o p e r a t i n g i n c o m e	20,847	13,631	40,752	25,173
I n t e r e s t e x p e n s e , n e t	762	1,023	1,591	2,045
Other expense (income), net	3	(15)	(12)	(36)
Income before income taxes	\$ 20,082	\$ 12,623	\$ 39,173	\$ 23,164

NOTE 9. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Authoritative guidance for financial assets and liabilities measured on a recurring basis applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. Fair value, as defined in the authoritative guidance, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance affects the fair value measurement of an investment with quoted market prices in an active market for identical instruments, which must be classified in one of the following categories:

#### Level 1 Inputs

These inputs come from quoted prices (unadjusted) in active markets for identical assets or liabilities.

#### Level 2 Inputs

These inputs are other than quoted prices that are observable for an asset or liability. These inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

#### Level 3 Inputs

These are unobservable inputs for the asset or liability which require the Company's own assumptions.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

The following presents the changes in Level 1 assets for the six months ended June 30, 2012 and 2011 (in thousands):

	2012	2011
Six Months Ended June 30		
Fair value at January 1	\$ 1,679 -	
Investment during period		105 -
Realized and unrealized gains (losses) included in other comprehensive income		(468) -
Fair value at June 30	\$ 1,316 -	

During the fourth quarter of 2011, the Company paid \$1,572,000 for an investment with quoted market prices in an active market. At December 31, 2011, the market value of this investment was \$1,679,000. During 2012, the Company paid \$105,000 for additional shares of this investment. At June 30, 2012, the market value of the investment was \$1,316,000. The \$468,000 decline in the market value during the six months ended June 30, 2012 was included in other comprehensive income in 2012.

NOTE 10: ACQUISITIONS

On October 10, 2011, DXP acquired substantially all of the assets of Kenneth Crosby ("KC"). DXP acquired this business to expand DXP's geographic presence in the eastern U.S. and strengthen DXP's metal working offering. DXP paid approximately \$16 million for KC, which was borrowed under our existing credit facility. Goodwill of \$5.8 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of KC with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce.

On December 30, 2011, DXP acquired substantially all of the assets of C.W. Rod Tool Company ("CW Rod"). DXP acquired this business to strengthen DXP's metal working offering. DXP paid approximately \$1.1 million of DXP's common stock (35,714 shares) and approximately \$43 million in cash for CW Rod, which was borrowed during 2011 and 2012 under our credit facility. The \$43 million of cash paid for CW Rod includes \$36.7 million paid in the form of checks which did not clear our bank until 2012. Goodwill of \$10.0 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of CW Rod with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce.

On January 31, 2012, DXP acquired substantially all of the assets of Mid-Continent Safety ("Mid-Continent"). DXP acquired this business to expand DXP's geographic presence in the Midwestern U.S. and strengthen DXP's safety products offering. DXP paid approximately \$3.8 million for Mid-Continent, which was borrowed under our existing credit facility. Goodwill of \$1.2 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of Mid-Continent with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce. All of the goodwill will be included in the Service Centers segment.

On February 29, 2012, DXP acquired substantially all of the assets of Pump & Power Equipment, Inc. ("Pump & Power"). DXP acquired this business to expand DXP's geographic presence in the Midwestern U.S. and strengthen DXP's municipal pump products and services offering. DXP paid approximately \$1.9 million for Pump & Power which was borrowed under our existing credit facility. Goodwill of \$0.7 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of Pump & Power with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce. All of the goodwill will be included in the Service Centers segment.

On May 1, 2012, DXP acquired the stock of Industrial Paramedic Services ("IPS"), a provider of industrial medical and safety services to industrial customers operating in remote locations and large facilities in western Canada. DXP acquired this business to expand DXP's geographic presence into Canada and to expand our safety services offering. IPS is headquartered in Calgary, Alberta and operates out of three locations in Calgary, Nisku and Dawson Creek. The \$24.1 million purchase price was financed with \$20.6 million of borrowings under DXP's existing credit facility, \$2.5 million of promissory notes bearing a 5% interest rate and 19,685 shares of DXP common stock. DXP



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has not completed appraisals of intangibles or property and equipment for IPS. DXP has made preliminary estimates for purposes of this disclosure. Estimated goodwill of \$11.9 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of IPS with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce. None of the estimated goodwill is expected to be tax deductible. All of the goodwill will be included in the Service Centers segment.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed during 2011 and 2012 in connection with the acquisitions described above and two small acquisitions completed in the second quarter of 2012 (in thousands):

Cash	\$ 696
Accounts Receivable, net	25,498
Inventory, net	15,856
Property and equipment	4,485
Goodwill and intangibles	68,793
Other assets	456
<b>Assets acquired</b>	<b>115,784</b>
Current liabilities assumed	(9,594)
Non-current liabilities assumed	(5,142)
<b>Net assets acquired</b>	<b>\$101,048</b>

The pro forma unaudited results of operations for the Company on a consolidated basis for the three months and six months ended June 30, 2011 and 2012, assuming the acquisition of businesses completed in 2011 and 2012 were consummated as of January 1, 2011 follows (unaudited, in thousands, except per share data):

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Net sales	\$ 264,177	\$ 237,251	\$ 527,290	\$ 457,836
Net income	12,139	9,575	24,317	17,515

Per share data				
B a s i c		\$0.67	\$1.69	\$1.22
earnings	\$0.84			
Diluted		\$0.63	\$1.60	\$1.15
earnings	\$0.80			

**NOTE 11: SUBSEQUENT EVENTS**

In May 2009, the FASB issued authoritative guidance which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The authoritative guidance provides guidance on the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company evaluated subsequent events through the date this report was filed with the SEC.

On July 11, 2012, DXP completed the acquisition of HSE Integrated Ltd. ("HSE"). Through its wholly-owned subsidiary, DXP Canada Enterprises Ltd., DXP acquired all of the outstanding common shares of HSE by way of a plan of arrangement under the Business Corporations Act (Alberta) (the "Arrangement"). Pursuant to the Arrangement, HSE shareholders received CDN \$1.80 in cash per each common share of HSE held. The total transaction value is approximately \$85 million, including approximately \$4 million in debt and approximately \$3 million in transaction costs. The purchase price was financed with borrowings under DXP's new \$325 million credit facility. DXP acquired HSE to expand our industrial health and safety services offering.

On July 11, 2012 DXP entered into a credit facility (the "Facility") with Wells Fargo Bank, National Association, as Issuing Lender, Swingline Lender and Administrative Agent for the lenders. The Facility consists of a \$100 million term loan and a revolving credit facility that provides a \$225 million line of credit to the Company. This Facility replaces the Company's prior credit facility, which was last amended on December 30, 2011 and consisted of a \$200 million revolving credit facility.

The new facility expires on July 11, 2017. The Facility contains financial covenants defining various financial measures and levels of these measures with which the Company must comply. Covenant compliance is assessed as of each quarter end. Approximately \$0.7 million of debt issuance costs associated with the prior credit facility will be expensed in the third quarter of 2012.

DXP has not completed appraisals of intangibles or property and equipment for HSE. DXP has made preliminary estimates for purposes of this disclosure. The estimate of goodwill for this acquisition is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of HSE with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce. None of the estimated \$17 million of goodwill is expected to be tax deductible. All of the goodwill and operations of HSE are expected to be included in the Service Centers segment.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed in the acquisition of HSE (in millions):

Cash	\$ 11
Accounts Receivable, net	24
Inventory, net	-
Property and equipment	33
Goodwill and intangibles	47
Other assets	2
Assets acquired	117
Current liabilities assumed	(14)
Non-current liabilities assumed	(18)
Net assets acquired	\$ 85

The preliminary estimated pro forma unaudited results of operations for the Company on a consolidated basis for the three months and six months ended June 30, 2011 and 2012, assuming the acquisition of HSE was consummated as of January 1, 2011 follows (unaudited, in thousands, except per share data):

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Net sales	\$290,481	\$223,399	\$570,872	\$431,296
Net income	12,696	7,654	25,588	13,493
Per share data				
Basic earnings	\$0.88	\$0.53	\$1.78	\$0.94
Diluted earnings	\$0.83	\$0.50	\$1.68	\$0.89

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this “Report”) contains statements that constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Such statements can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “estimates”, “will”, “should”, “pl

“anticipates” or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and actual results may vary materially from those discussed in the forward-looking statements as a result of various factors. These factors include the effectiveness of management’s strategies and decisions, our ability to affect our internal growth strategy, general economic and business conditions, developments in technology, our ability to effectively integrate businesses we may acquire, new or modified statutory or regulatory requirements and changing prices and market conditions. This Report identifies other factors that could cause such differences. Additional factors that could cause or contribute to actual results varying materially from those discussed in the forward-looking statements are discussed in the section titled “Risk Factors” included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 9, 2012. We cannot assure you that these are all of the factors that could cause actual results to vary materially from the forward-looking statements. We assume no obligation and do not intend to update these forward-looking statements.. Unless the context otherwise requires, references in this Report to the "Company", "DXP", “We” or “Our” shall mean DXP Enterprises, Inc., a Texas corporation, together with its subsidiaries.

## RESULTS OF OPERATIONS

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012	%	2011	%	2012	%	2011	%
Sales	\$261,894	100.0	\$197,675	100.0	\$514,181	100.0	\$380,762	100.0
Cost of sales	185,265	70.7	140,410	71.0	366,078	71.2	271,070	71.2
Gross profit	76,629	29.3	57,265	29.0	148,103	28.8	109,692	28.8
Selling, general and administrative expense	55,782	21.3	43,634	22.1	107,351	20.9	84,519	22.2
Operating income	20,847	8.0	13,631	6.9	40,752	7.9	25,173	6.6
Interest expense	(762)	(0.3)	(1,023)	(0.5)	(1,591)	(0.3)	(2,045)	(0.5)
Other income	(3)	-	15	-	12	-	36	-
Income before income taxes	20,082	7.7	12,623	6.4	39,173	7.6	23,164	6.1
Provision for income taxes	7,905	3.0	5,013	2.5	15,350	3.0	9,211	2.4
Net income	\$ 12,177	4.7	\$ 7,610	3.9	\$ 23,823	4.6	\$ 13,953	3.7
Per share amounts								
Basic earnings per share	\$ 0.84		\$ 0.53		\$ 1.66		\$ 0.97	
Diluted earnings per share	\$ 0.80		\$ 0.50		\$ 1.57		\$ 0.92	

DXP is organized into three business segments: Service Centers, Supply Chain Services (“SCS”) and Innovative Pumping Solutions (“IPS”). The Service Centers are engaged in providing maintenance, repair and operating products, equipment and services, including logistics capabilities, to industrial customers. The Service Centers provide a wide range of MRO products in the rotating equipment, bearing, power transmission equipment, metal working, hose,

industrial supplies, safety service and safety product categories. The IPS segment fabricates and assembles custom-made engineered pump packages. The SCS segment manages all or part of a customer's supply chain, including warehouse and inventory management.

Three Months Ended June 30, 2012 compared to Three Months Ended June 30, 2011

**SALES.** Sales for the quarter ended June 30, 2012 increased \$64.2 million, or 32.5%, to approximately \$261.9 million from \$197.7 million for the same period in 2011. Sales by businesses acquired since June 30, 2011 accounted for \$39.0 million of 2012 sales. Excluding 2012 sales by businesses acquired in 2011 and 2012, sales for 2012 increased 12.8% from 2011, on a same store sales basis. This sales increase is primarily due to improvement in the oil and gas and manufacturing portions of the U.S. economy.

**GROSS PROFIT.** Gross profit as a percentage of sales increased to 29.3% for the second quarter of 2012, compared to 29.0% for the same period in 2011. This increase is primarily the result of the increased gross margins in our IPS and SCS segments.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the quarter ended June 30, 2012 increased by approximately \$12.1 million when compared to the same period in 2011. The majority of the increase relates to \$8.7 million of selling, general and administrative expense associated with businesses acquired in 2011 and 2012. Excluding expenses for businesses acquired in 2011 and 2012, the increase primarily resulted from increased salaries, incentive compensation, employee benefits, professional fees and travel expenses compared to 2011. As a percentage of sales, the 2012 expense decreased to 21.3%, from 22.1% for the quarter ended June 30, 2011.

**OPERATING INCOME.** Operating income for the second quarter of 2012 increased 52.9% compared to the same period in 2011. This increase in operating income is the result of gross profit increasing 33.8%, while selling, general and administrative expense increased only 27.8%.

**INTEREST EXPENSE.** Interest expense for the quarter ended June 30, 2012 decreased 25.5% from the same period in 2011. This decrease primarily resulted from lower average interest rates. On July 25, 2011, we amended our credit facility. This amendment significantly decreased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before July 25, 2011.

**SERVICE CENTERS SEGMENT.** Sales for the Service Centers segment increased \$44.6 million, or 32.0%. Excluding 2012 Service Centers segment sales of \$34.5 million by businesses acquired in 2011 and 2012, Service Centers segment sales for the second quarter of 2012 increased 7.2% from 2011, on a same store sales basis. This sales increase is primarily due to improvement in the oil and gas and manufacturing portions of the U.S. economy. Operating income for the Service Centers segment increased 29.7%, primarily as a result of the 32.0% increase in sales.

**SUPPLY CHAIN SERVICES SEGMENT.** Sales for the SCS segment increased by \$6.2 million, or 17.2%, for the second quarter of 2012 compared to the second quarter of 2011. Excluding SCS segment sales of \$4.4 million by businesses acquired in 2011 and 2012, SCS segment sales for the second quarter of 2012 increased 5.0% from 2011, on a same store sales basis. Operating income for the SCS segment increased 82.7% primarily as a result of the 22.7% increase in gross profit for this segment combined with a decline in selling, general and administrative expense.

**INNOVATIVE PUMPING SOLUTIONS SEGMENT.** Sales for the IPS segment increased by \$13.4 million, or 61.3% for the second quarter of 2012 compared to the second quarter of 2011. The sales increase resulted from the increase in capital spending by our oil and gas and mining related customers. Operating income for the IPS segment increased 124.9% as a result of the 61.3% increase in sales combined with only a 49.0% increase in selling, general and administrative expenses.

Six Months Ended June 30, 2012 compared to Six Months Ended June 30, 2011

**SALES.** Sales for the six months ended June 30, 2012 increased \$133.4 million, or 35.0%, to approximately \$514.2 million from \$380.8 million for the same period in 2011. Sales by businesses acquired since June 30, 2011, accounted for \$70.8 million of 2012 sales. Excluding 2012 sales by businesses acquired in 2011 and 2012, sales for 2012 increased 16.4% from 2011 on a same store sales basis. This sales increase is primarily due to improvement in the oil and gas and manufacturing portions of the U.S. economy.

**GROSS PROFIT.** Gross profit as a percentage of sales was 28.8% for the first six months of 2012 and 2011.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the six months ended June 30, 2012 increased by approximately \$22.8 million when compared to the same period in 2011. The majority of the increase relates to \$14.4 million of selling, general and administrative expense associated with businesses acquired in 2011 and 2012. Excluding expenses for businesses acquired in 2011 and 2012, the increase primarily resulted from increased salaries, incentive compensation, employee benefits and travel expenses compared to 2011. As a percentage of sales, the 2012 expense decreased to 20.9%, from 22.2% for the six months ended June 30, 2011.

**OPERATING INCOME.** Operating income for the first six months of 2012 increased 61.9% compared to the same period in 2011. This increase in operating income is the result of gross profit increasing 35.0%, while selling, general and administrative expense increased only 27.0%.

**INTEREST EXPENSE.** Interest expense for the six months ended June 30, 2012 decreased 22.2% from the same period in 2011. This decrease primarily resulted from lower average interest rates. On July 25, 2011, we amended our credit facility. This amendment significantly decreased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before July 25, 2011.

**SERVICE CENTERS SEGMENT.** Sales for the Service Centers segment increased \$88.1 million, or 32.5%. Excluding 2012 Service Centers segment sales of \$63.8 million by businesses acquired in 2011 and 2012, Service Centers segment sales for the first six months of 2012 increased 9.0% from 2011, on a same store sales basis. This sales increase is primarily due to improvement in the oil and gas and manufacturing portions of the U.S. economy. Operating income for the Service Centers segment increased 27.8%, primarily as a result of the 29.8% increase in gross profit.

**SUPPLY CHAIN SERVICES SEGMENT.** Sales for the SCS segment increased by \$9.2 million, or 12.9%, for the first six months of 2012 compared to the first six months of 2011. Excluding SCS segment sales of \$7.1 million by businesses acquired in 2011 and 2012, SCS segment sales for 2012 increased 3.0% from 2011, on a same store sales basis. Operating income for the SCS segment increased 65.9% primarily as a result of the 12.9% increase in sales for this segment combined with a decline in selling, general and administrative expense.

**INNOVATIVE PUMPING SOLUTIONS SEGMENT.** Sales for the IPS segment increased by \$36.1 million, or 93.8% for the first six months of 2012 compared to the first six months of 2011. The sales increase resulted from the increase in capital spending by our oil and gas and mining related customers. Operating income for the IPS segment increased 155.5% as a result of the 93.8% increase in sales combined with only a 44.6% increase in selling, general and administrative expenses.

## LIQUIDITY AND CAPITAL RESOURCES

### General Overview

As a distributor of MRO products, equipment and services, we require significant amounts of working capital to fund inventories and accounts receivable. Additional cash is required for capital items such as information technology, safety, transportation and warehouse equipment. We also require cash to pay our lease obligations and to service our debt.

We generated \$24.9 million of cash in operating activities during the first six months of 2012 as compared to generating \$16.3 million during the first six months of 2011. This change between the two periods was primarily attributable to the \$9.9 million increase in net income.

During the first six months of 2012, the amount available to be borrowed under our credit agreement with our bank lender (the "Facility") decreased from \$78.2 million at December 31, 2011 to \$24.6 million at June 30, 2012. This decrease in availability primarily resulted from \$73.5 million borrowed to fund acquisitions, partially offset by cash flow from operations.

On August 28, 2008, DXP entered into a credit agreement with Wells Fargo Bank, National Association, as lead arranger and administrative agent for the lenders (the "Facility"). The Facility was amended on March 15, 2010. The March 15, 2010 amendment to the Facility significantly increased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before March 15, 2010. Effective July 25, 2011 DXP entered into a Second Amendment to the Credit Facility with Wells Fargo Bank, National Association. The Second Amendment reduced interest rates; deleted the Senior Leverage Ratio; increased the maximum leverage ratio to not greater than 4.00 to 1.00 as of the last day of each quarter; allows DXP to purchase, redeem and retire equity for aggregate consideration not exceeding \$5.0 million; and modified covenants to increase DXP's ability to complete future acquisitions. The term loan was repaid using funds from the \$150 million line of credit. Effective December 30, 2011 DXP entered into a Third Amendment to the Facility. The Third Amendment increased the maximum amount of the Facility from \$150 million to \$200 million. The Facility provided the option of interest at LIBOR plus a margin ranging from 1.25% to 2.75%, or prime plus a margin of minus 0.25% to 1.25%. Commitment fees of 0.15% to 0.40% per annum were payable on the portion of the Facility capacity not in use for borrowings or letters of credit at any given time. The Facility was scheduled to expire on July 25, 2016. The Facility consisted of a revolving credit facility that provided a \$200 million line of credit to the Company. The Facility contained financial covenants defining various financial measures and levels of these measures with which the Company must comply. Covenant compliance was assessed as of each quarter end and certain month ends for the asset test. The asset test was defined under the Facility as the sum of 90% of the Company's net accounts receivable, 65% of net inventory, and 50% of the net book value of non real estate property and equipment. The Company's borrowing and letter of credit capacity under the revolving credit portion of the Facility at any given time was \$200 million less borrowings under the revolving credit portion of the facility and letters of credit outstanding, subject to the asset test described above.

On June 30, 2012, the LIBOR based rate of the Facility was LIBOR plus 1.25%, the prime based rate of the Facility was prime minus 0.25% and the commitment fee was 0.15%. At June 30, 2012, \$175 million was borrowed under the Facility at a weighted average interest rate of approximately 1.50% under the LIBOR options. Borrowings under the Facility were secured by all of the Company's accounts receivable, inventory, general intangibles and non real estate property and equipment. At June 30, 2012, \$24.6 million was available for borrowing under the Facility.

The Facility's principal financial covenants included:

**Fixed Charge Coverage Ratio** –The Facility required that the Fixed Charge Coverage Ratio for the 12 month period ending on the last day of each quarter be not less than 1.50 to 1.0 with "Fixed Charge Coverage Ratio" defined as the ratio of (a) EBITDA for the 12 months ending on such date minus cash taxes and Capital Expenditures for such period (excluding acquisitions) to (b) the aggregate of interest expense paid in cash, scheduled principal payments in respect of long-term debt and current portion of capital leases for such 12-month period, determined in each case on a consolidated basis for DXP and its subsidiaries. At June 30, 2012, the Company's Fixed Charge Coverage Ratio was 9.6 to 1.00

Leverage Ratio – The Facility required that the Company’s Leverage Ratio, determined at the end of each fiscal quarter, not exceed 4.0 to 1.0 as of the last day of each quarter. The Leverage Ratio was defined as the outstanding Indebtedness divided by EBITDA for the 12 months then ended. At June 30, 2012, the Company’s Leverage Ratio was 1.91 to 1.00. Indebtedness is defined under the Facility for financial covenant purposes as: (a) all obligations of DXP for borrowed money including but not limited to senior bank debt, senior notes and subordinated debt; (b) capital leases; (c) issued and outstanding letters of credit; and (d) contingent obligations for funded indebtedness.

The following is the computation of the Leverage Ratio as of June 30, 2012 (in thousands, except for ratios):

F o r t h e T w e l v e Months ended June 30, 2012	Leverage Ratio
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Income before taxes	\$ 68,004
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I n t e r e s t expense	3,064
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D e p r e c i a t i o n a n d amortization	11,949
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S t o c k compensation expense	1,608
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P r o f o r m a a c q u i s i t i o n EBITDA	10,894
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R e d u c t i o n o f c l o s e d l o c a t i o n accrual	(232)
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(A) Defined EBITDA	95,287
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As of June 30, 2012	
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T o t a l l o n g - t e r m debt	\$181,281
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L e t t e r s o f c r e d i t outstanding	431
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(B) Defined indebtedness	\$181,712
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L e v e r a g e Ratio (B)/(A)	1.91
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EBITDA as defined under the Facility for financial covenant purposes means, without duplication, for any period the consolidated net income (excluding any extraordinary gains or losses) of DXP plus, to the extent deducted in calculating consolidated net income, depreciation, amortization, other non-cash items and non-recurring items (including, without limitation, impairment charges, asset write-offs and accruals in respect of closed locations), interest expense and tax expense for taxes based on income and minus, to the extent added in calculating consolidated net income, any non-cash items and non-recurring items; provided that, if DXP acquires the equity interests or assets of any person during such period under circumstances permitted under the Facility, EBITDA shall be adjusted to give pro forma effect to such acquisition assuming that such transaction had occurred on the first day of such period and provided further that, if DXP divests the equity interests or assets of any person during such period under circumstances permitted under the Facility, EBITDA shall be adjusted to give pro forma effect to such divestiture assuming that such transaction had occurred on the first day of such period. Add-backs allowed pursuant to Article 11, Regulation S-X, of the Securities Act of 1933, as amended, will also be included in the calculation of EBITDA.

On July 11, 2012 DXP entered into a credit facility with Wells Fargo Bank, National Association, as Issuing Lender, Swingline Lender and Administrative Agent for the lenders. The new facility consists of a \$100 million term loan and a revolving credit facility that provides a \$225 million line of credit to the Company. This new facility replaced the Company's prior credit facility, which was last amended on December 30, 2011 and consisted of a \$200 million revolving credit facility. The pricing grid for the new facility is almost the same as the prior facility. The primary differences are the rates for the \$100 million term loan component are 25 basis points higher than the non-term loan borrowings and the unused line fees will be 5 basis points higher than the old agreement. Because the leverage ratio is higher after completion of the HSE acquisition, interest rates are expected to be 50 to 75 basis points higher than in effect at June 30, 2012.

The new facility expires on July 11, 2017. The Facility contains financial covenants defining various financial measures and levels of these measures with which the Company must comply. Covenant compliance is assessed as of each quarter end. Approximately \$0.7 million of debt issuance costs associated with the prior credit facility will be expensed in the third quarter of 2012.

#### Borrowings

	June 30, 2012	December 31, 2011	Increase (Decrease)
(in Thousands)			
Current portion of long-term debt	\$ 3,127	\$ 694	\$ 2,433
Long-term debt, less current portion	178,154	114,205	63,949
T o t a l long-term debt	181,281	\$ 114,899	\$ 66,382(2)
A m o u n t available	\$ 24,569(1)	\$ 78,201(1)	\$ (53,632) (3)

(1) Represents amount available to be borrowed at the indicated date under the Facility.

(2) The funds obtained from the increase in debt were used to fund acquisitions.

(3) The \$53.6 million decrease in the amount available is primarily a result of borrowing to fund acquisitions, partially offset by cash flow from operations.

## Performance Metrics

	June 30, Increase	
	2012	2011 (Decrease)
	(in Days)	
Days of sales outstanding	55.9	56.8 (0.9)
Inventory turns	7.5	7.0 0.5

Accounts receivable days of sales outstanding were 55.9 days at June 30, 2012 compared to 56.8 days at June 30, 2011. The decrease resulted primarily from a change in customer mix which resulted in faster collection of accounts receivable. Annualized inventory turns were 7.5 at June 30, 2012 and 7.0 at June 30, 2011. The increase in inventory turns resulted from the increase in sales.

## Funding Commitments

We believe our cash generated from operations and available under our Facility will meet our normal working capital needs during the next twelve months. However, we may require additional debt or equity financing to fund potential acquisitions. Such additional financings may include additional bank debt or the public or private sale of debt or equity securities. In connection with any such financing, we may issue securities that substantially dilute the interests of our shareholders. We may not be able to obtain additional financing on attractive terms, if at all.

## Share Repurchases

During the six months ended June 30, 2012, DXP repurchased 10,300 shares of DXP's common stock.

On October 26, 2011, the Board of Directors authorized DXP from time to time to purchase up to 200,000 shares of DXP's common stock over 24 months. DXP publicly announced the authorization that day. Purchases may be made in open market or in privately negotiated transactions. DXP had purchased 10,300 shares under this authorization as of June 30, 2012.

## Acquisitions

All of the Company's acquisitions have been accounted for using the purchase method of accounting. Revenues and expenses of the acquired businesses have been included in the accompanying consolidated financial statements beginning on their respective dates of acquisition. The allocation of purchase price to the acquired assets and liabilities is based on estimates of fair market value.

## DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported

amounts of revenues and expenses during the reporting period. The significant estimates made by us in the accompanying financial statements relate to reserves for accounts receivable collectability, inventory valuations, income taxes, self-insured liability claims and self-insured medical claims. Actual results could differ from those estimates. Management periodically re-evaluates these estimates as events and circumstances change. Together with the effects of the matters discussed above, these factors may significantly impact the Company's results of operations from period-to-period.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's subjective or complex judgments. These policies have been discussed with the Audit Committee of the Board of Directors of DXP. Below is a discussion of what we believe are our critical accounting policies.

#### Revenue Recognition

For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues using the percentage of completion method. Under this method, revenues are recognized as costs are incurred and include estimated profits calculated on the basis of the relationship between costs incurred and total estimated costs at completion. If at any time expected costs exceed the value of the contract, the loss is recognized immediately. Approximately \$12.6 million of revenues were recognized on contracts in process as of June 30, 2012. The typical time span of these contracts is approximately one to two years.

For other sales, the Company recognizes revenues when an agreement is in place, the price is fixed, title for product passes to the customer or services have been provided and collectability is reasonably assured. Revenues are recorded net of sales taxes. Revenues recognized include product sales and billings for freight and handling charges.

#### Allowance for Doubtful Accounts

Provisions to the allowance for doubtful accounts are made monthly and adjustments are made periodically (as circumstances warrant) based upon the expected collectability of all such accounts. Write-offs could be materially different from the reserve provided if economic conditions change or actual results deviate from historical trends.

#### Inventory

Inventory consists principally of finished goods and is priced at lower of cost or market, cost being determined using the first-in, first-out (FIFO) method. Reserves are provided against inventory for estimated obsolescence based upon the aging of the inventory and market trends. Actual obsolescence could be materially different from the reserve if economic conditions or market trends change significantly.

#### Self-insured Insurance and Medical Claims

We generally retain up to \$100,000 of risk for each claim for workers compensation, general liability, automobile and property loss. We accrue for the estimated loss on the self-insured portion of these claims. The accrual is adjusted quarterly based upon reported claims information. The actual cost could deviate from the recorded estimate.

We generally retain up to \$200,000 of risk on each medical claim for our employees and dependents. We accrue for the estimated outstanding balance of unpaid medical claims for our employees and their dependents. The accrual is adjusted monthly based on recent claims experience. The actual claims could deviate from recent claims experience and be materially different from the reserve.

The accrual for these claims at December 31, 2011 and June 30, 2012 was approximately \$2.4 million and \$2.9 million, respectively.

#### Impairment of Long-Lived Assets and Goodwill

Goodwill represents a significant portion of our total assets. We review goodwill for impairment annually during our fourth quarter, or more frequently if certain impairment indicators arise under the provisions of authoritative guidance. We review goodwill at the reporting level unit, which is one level below an operating segment. In the fourth quarter of 2011, in conjunction with our December 31, 2011 goodwill assessment, we adopted new accounting guidance that allows an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount and if a quantitative assessment should be performed. As of December 31, 2011, we performed a qualitative analysis and concluded it is more likely than not that the fair value of each reporting unit was not less than its carrying value and therefore, did not perform a quantitative analysis. Accordingly, the annual impairment assessment at December 31, 2011 indicated there was no impairment of goodwill. Qualitative factors considered during our assessment included the capital markets environment, U.S. economic conditions, industrial distribution industry competition and trends, oil and gas exploration and production industry trends, changes in our results of operations, the magnitude of the excess of fair value over the carrying amount of each reporting unit as determined in prior years' quantitative testing and other factors. We believe the fair value of our reporting units substantially exceeds the carrying value of our reporting units.

If the annual qualitative assessment determines a quantitative assessment should be performed, we would compare the carrying value of the net assets of each reporting unit to the net present value of estimated discounted anticipated cash flows of each reporting unit, discounted using a weighted average cost of capital rate. If the carrying value exceeds the net present value of estimated discounted anticipated cash flows, an impairment indicator would exist and an estimate of the impairment loss would be calculated. The fair value calculation would include management views and multiple assumptions and estimates, including the projected cash flows and discount rates applied. Estimated cash flows would be primarily based on projected revenues, operating costs and capital expenditures and would be discounted based on comparable industry average rates for weighted average cost of capital. Changes in these assumptions and estimates could result in goodwill impairment that could have materially adverse impacts our financial position or results of operations. Assets, liabilities, deferred taxes and goodwill for each reporting unit would be determined using the balance sheets maintained for each reporting unit.

Goodwill of \$119.8 million was primarily recorded in connection with the 22 acquisitions completed since 2004. Approximately \$16.0 million of goodwill is included in our IPS segment. Approximately \$95.9 million of goodwill is included in the two reporting units for our Service Centers segment which are DXP and PFI. Approximately \$7.9 million of goodwill is included in our SCS segment.

Long-lived assets, including property, plant and equipment and amortizable intangible assets comprise a significant portion of our total assets. We evaluate the carrying value of long-lived assets when impairment indicators are present or when circumstances indicate that impairment may exist under authoritative guidance. When events or changes in circumstances indicate that a long-lived asset carrying amount may not be recoverable, a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Depending on the circumstances, this could be at a reporting unit or segment level. Estimates of future cash flows are generally used to test the recoverability of a long-lived asset (asset group), unless market information is available that would more clearly indicate the fair value of an asset or asset group. To the extent estimates of future cash flows are utilized, only the future cash flows (cash inflows less associated cash outflows) that are directly associated with, and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group) are utilized. Those estimates shall exclude interest charges that will be recognized as an expense when incurred. These impairment tests are heavily influenced by assumptions and estimates that are subject to change as additional information becomes available. We concluded

DXP did not have an impairment of long-lived assets during 2011.

The following are examples of events or changes in circumstances that might suggest an asset or asset group should be tested for impairment:

- a. A significant decrease in the market price of a long-lived asset (asset group)
- b. A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
- c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
- d. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
- e. A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

#### Purchase Accounting

The Company estimates the fair value of assets, including property, machinery and equipment and their related useful lives and salvage values, intangibles, and liabilities when allocating the purchase price of an acquisition.

#### Cost of Sales and Selling, General and Administrative Expense

Cost of sales includes product and product related costs, inbound freight charges, internal transfer costs and depreciation. Selling, general and administrative expense includes purchasing and receiving costs, inspection costs, warehousing costs, depreciation and amortization. DXP's gross margins may not be comparable to those of other entities, since some entities include all of the costs related to their distribution network in cost of sales and others like DXP exclude a portion of these costs from gross margin, including the costs in a line item, such as selling, general and administrative expense.

#### Income Taxes

Deferred income tax assets and liabilities are computed for differences between the financial statement and income tax bases of assets and liabilities. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to reverse. Valuation allowances are established to reduce deferred income tax assets to the amounts expected to be realized.

#### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our market risk results from volatility in interest rates. Our exposure to interest rate risk relates primarily to our debt portfolio. Using floating interest rate debt outstanding at June 30, 2012, a 100 basis point change in interest rates would result in approximately a \$1,750,000 change in annual interest expense.

#### ITEM 4: CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) was evaluated by our management with the participation of our President and Chief Executive Officer, David R. Little (principal executive officer), and our Senior Vice President and Chief Financial Officer, Mac McConnell (principal financial officer). Messrs. Little and McConnell have concluded that our disclosure controls and procedures are effective, as of the end of the period covered by this Quarterly Report on Form 10-Q, to help ensure that information we are required to disclose in reports that we file with the SEC is accumulated and communicated to

management and recorded, processed, summarized and reported within the time periods prescribed by the SEC.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter (the quarter ended June 30, 2012) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II: OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

No material developments have occurred in the litigation with BP America Production Company disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 1, 2012, DXP issued 19,685 unregistered shares of DXP Common Stock in connection with the acquisition of Industrial Paramedic Services.

#### ISSUER PURCHASES OF EQUITY SECURITIES

			(c) Total Number of Shares (or Units)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased Under the Plans or Programs
	(a) Total Number of Shares (or Units)	(b) Average Price Paid per Share (or Unit)	(b) Purchased as Part of Publicly Announced Plans or Programs	
April 1, 2012 - April 30, 2012				
May 1, 2012 - May 30, 2012				
June 1, 2012 - June 30, 2012	10,300	\$37.53	10,300	189,700

2012

Total	10,300	\$37.53	10,300	189,700
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On October 26, 2011, the Board of Directors authorized DXP from time to time to purchase up to 200,000 shares of DXP's common stock over 24 months. DXP publicly announced the authorization that day. Purchases may be made in open market or in privately negotiated transactions. DXP had purchased 10,300 shares under this authorization as of June 30, 2012.

## ITEM 6. EXHIBITS

- 3.1 Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with Commission on August 20, 1998).
- 3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4 (Reg. No. 333-10021), filed with the Commission on August 12, 1996).
- 3.3 Amendment No. 1 to Bylaws (incorporated by reference to Exhibit A to the Registrant's Current Report on Form 8-K, filed with the Commission on July 28, 2011).
- 10.1 Amendment One to David Little Equity Incentive Program (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Commission on May 11, 2012).
- 10.2 Arrangement Agreement, dated as of April 30, 2012, whereby DXP Enterprises, Inc. agreed to acquire all of the shares of HSE Integrated Ltd., (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Commission on May 1, 2012).
- 10.3 Schedule A to the Arrangement Agreement dated April 30, 2012 between HSE Integrated Ltd., DXP Canada Enterprises Ltd. and DXP Enterprises, Inc., Plan of Arrangement Under Section 193 of the Business Corporations Act (Alberta) (amended as of and effective June 28, 2012) (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Commission on July 13, 2012).
- 10.4 Credit Agreement by and among DXP Enterprises, Inc., as US Borrower, DXP Canada Enterprises Ltd., as Canadian Borrower, and Wells Fargo Bank, National Association, as Issuing Lender, Swingline Lender and Administrative Agent for the Lenders, dated as of July 11, 2012 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, filed with the Commission on July 13, 2012).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101\*\*Interactive Data Files (to be filed by amendment)

\*\*Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.

#### SIGNATURES

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.

DXP ENTERPRISES, INC.

(Registrant)

By: /s/MAC McCONNELL

Mac McConnell

Senior Vice-President/Finance and

Chief Financial Officer

(Duly Authorized Signatory and Principal Financial Officer)

Dated: August 9, 2012

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