

DXP ENTERPRISES INC
Form 10-Q
May 04, 2011

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 March 31, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from

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

Texas
(State or other jurisdiction of incorporation or organization)

76-0509661
(I.R.S. Employer Identification Number)

7272 Pinemont, Houston, Texas 77040
(Address of principal executive offices)

(713) 996-4700
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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes
[] No [X]

Number of shares of registrant's Common Stock outstanding as of May 2, 2011: 14,105,360.

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)

	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash	\$ 3,348	\$ 770
Trade accounts receivable, net of allowances for doubtful accounts		
of \$3,683 in 2011 and \$3,540 in 2010	110,734	99,781
Inventories, net	79,075	75,887
Prepaid expenses and other current assets	3,215	2,550
Federal income tax receivable	-	402
Deferred income taxes	4,100	5,919
Total current assets	200,472	185,309
Property and equipment, net	14,612	14,917
Goodwill	84,942	84,942
Other intangibles, net of accumulated amortization of \$21,209 in 2011 and \$19,603 in 2010	30,630	32,236
Non-current deferred income taxes	2,587	2,289
Other assets	943	931
Total assets	\$ 334,186	\$ 320,624
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 10,925	\$ 10,930
Trade accounts payable	62,238	55,019
Accrued wages and benefits	11,619	11,826
Customer advances	9,732	10,271
Federal income taxes payable	1,524	-
Other accrued liabilities	8,441	4,837
Total current liabilities	104,479	92,883
Long-term debt, less current portion	98,897	103,621
Shareholders' equity:		

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Series A preferred stock, 1/10th vote per share; \$1.00 par value;	1	1
liquidation preference of \$100 per share (\$112 at March 31, 2011);		
1,000,000 shares authorized; 1,122 shares issued and outstanding		
Series B convertible preferred stock, 1/10th vote per share; \$1.00		
par value; \$100 stated value; liquidation preference of \$100 per		
share (\$1,500 at March 31, 2011); 1,000,000 shares authorized;		
15,000 shares issued and outstanding	15	15
Common stock, \$0.01 par value, 100,000,000 shares authorized;		
14,097,360 in 2011 and 14,079,608 in 2010 shares outstanding	140	140
Paid-in capital	72,986	72,616
Retained earnings	57,668	51,348
Total shareholders' equity	130,810	124,120
Total liabilities and shareholders' equity	\$ 334,186	\$ 320,624

See notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2011	2010
Sales	\$ 183,087	\$ 146,992
Cost of sales	130,660	105,037
Gross profit	52,427	41,955
Selling, general and administrative expense	40,885	35,208
Operating income	11,542	6,747
Other income	21	203
Interest expense	(1,022)	(994)
Income before income taxes	10,541	5,956
Provision for income taxes	4,198	2,364
Net income	6,343	3,592
Preferred stock dividend	(23)	(23)
Net income attributable to common shareholders	\$ 6,320	\$ 3,569
Basic income per share	\$ 0.44	\$ 0.27
Weighted average common shares outstanding	14,279	13,159
Diluted income per share	\$ 0.42	\$ 0.26
Weighted average common and common equivalent shares outstanding	15,119	14,028

See notes to condensed consolidated financial statements.

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

	THREE MONTHS ENDED	
	MARCH 31	
	2011	2010
OPERATING ACTIVITIES:		
Net income	\$ 6,343	\$ 3,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	785	923
Amortization of intangibles	1,606	1,299
Compensation expense for restricted stock	280	252
Tax benefit related to exercise of stock options and vesting of restricted stock	(97)	(101)
Deferred income taxes	1,521	77
Gain on sale of property and equipment	-	(188)
Changes in operating assets and liabilities:		
Trade accounts receivable	(10,953)	(6,144)
Inventories	(3,188)	1,487
Prepaid expenses and other current assets	(579)	(648)
Accounts payable and accrued expenses	12,002	5,265
Net cash provided by operating activities	7,720	5,814
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(487)	(169)
Proceeds from the sale of business	-	1,428
Net cash provided by (used in) investing activities	(487)	1,259
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	39,043	33,935
Principal payments on revolving line of credit and other long-term debt	(43,772)	(39,244)
Dividends paid in cash	(23)	(23)

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Tax benefit related to exercise of stock options and vesting of restricted stock	97	101
Net cash used in financing activities	(4,655)	(5,231)
INCREASE IN CASH	2,578	1,842
CASH AT BEGINNING OF PERIOD	770	2,344
CASH AT END OF PERIOD	\$ 3,348	\$ 4,186

See notes to condensed consolidated financial statements.

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

THREE MONTHS ENDED			
MARCH 31,			
		2011	2010
Net income	\$	6,343	\$ 3,592
Gain from interest rate swap, net of income taxes		-	26
Comprehensive income	\$	6,343	\$ 3,618

See notes to 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, 2010, filed with the Securities and Exchange Commission.

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 ("DXP" or the "Company") is 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 October 2009, the Financial Accounting Standards Board ("FASB") issued new standards for revenue recognition with multiple deliverables. These new standards impact the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units for accounting purposes. Additionally, these new standards modify the manner in which the arrangement consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. These new standards were adopted in the first quarter of 2011. The adoption of these new standards did not significantly impact our consolidated financial statements.

NOTE 4: STOCK-BASED COMPENSATION

Stock Options

No future grants will be made under the Company's stock option plans. No grants of stock options have been made by the Company since July 1, 2005. As of January 1, 2011, no options were outstanding.

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 as of March 31, 2011 vest 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 March 31, 2011:

Number of shares authorized for grants	600,000
Number of shares granted	(557,262)
Number of shares forfeited	60,051
Number of shares available for future grants	102,789
Weighted-average grant price of granted shares	\$16.15

Changes in restricted stock for the three months ended March 31, 2011 were as follows:

	Number of Shares	Weighted Average Grant Price
Non-vested at December 31, 2010	180,056	\$ 16.15
Granted	62,600	\$ 22.11
Vested	(17,752)	\$ 11.34
Non-vested at March 31, 2011	224,904	\$ 18.19

Compensation expense, associated with restricted stock, recognized in the three months ended March 31, 2011 and 2010 was \$280,000 and \$252,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$3,527,000 and \$2,423,000 at March 31, 2011 and December 31, 2010, respectively. As of March 31, 2011, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 33 months.

NOTE 5: INVENTORY

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

	March 31, 2011	December 31, 2010
Finished goods	\$ 75,089	\$ 73,421

Work in process	3,986	2,466
Inventories	\$ 79,075	\$ 75,887

NOTE 6: GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill and other intangibles during the three months ended March 31, 2011 are as follows (in thousands):

	Total	Goodwill	Other Intangibles
Balance as of December 31, 2010	\$ 117,178	\$ 84,942	\$ 32,236
Acquired during the year	-	-	-
Adjustments to prior year estimates	-	-	-
Amortization	(1,606)	-	(1,606)
Balance as of March 31, 2011	\$ 115,572	\$ 84,942	\$ 30,630

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

	As of March 31, 2011		As of December 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
V e n d o r agreements	\$ 2,496	\$ (862)	\$ 2,496	\$ (831)
C u s t o m e r relationships	47,363	(18,769)	47,363	(17,237)
N o n - c o m p e t e agreements	1,980	(1,578)	1,980	(1,535)
Total	\$ 51,839	\$ (21,209)	\$ 51,839	\$ (19,603)

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 March 31,	
	2011	2010
Basic:		
Weighted average shares outstanding	14,279,027	13,159,149
Net income	\$ 6,343,000	\$ 3,592,000
Convertible preferred stock dividend	(23,000)	(23,000)
Net income attributable to common shareholders	\$ 6,320,000	\$ 3,569,000
Per share amount	\$ 0.44	\$ 0.27
Diluted:		
Weighted average shares outstanding	14,279,027	13,159,149
Net effect of dilutive stock options – based on the treasury stock method	-	28,623
Assumed conversion of convertible preferred stock	840,000	840,000
Total	15,119,027	14,027,772
Net income attributable to common shareholders	\$ 6,320,000	\$ 3,569,000
Convertible preferred stock dividend	23,000	23,000

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Net income for diluted earnings per share	\$ 6,343,000	\$ 3,592,000
Per share amount	\$ 0.42	\$ 0.26

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, industrial supply and safety products and 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 customer supply chains, 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:

	Three Months ended March 31,			
	Service Centers	Innovative Pumping Solutions	Supply Chain Services	Total
2011				
Sales	\$ 131,551	\$ 16,685	\$ 34,851	\$ 183,087
Operating income for reportable segments	14,781	2,858	1,914	19,553
2010				
Sales	\$ 103,294	\$ 12,277	\$ 31,421	\$ 146,992
Operating income for reportable segments	8,551	2,460	2,162	13,173

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

	Three Months Ended March 31,	
	2011	2010
Operating income for reportable segments	\$ 19,553	\$ 13,173
Adjustment for:		
Amortization of intangibles	1,606	1,299
Corporate and other expense, net	6,405	5,127
Total operating income	11,542	6,747
Interest expense, net	1,022	994
Other expense (income), net	(21)	(203)
Income before income taxes	\$ 10,541	\$ 5,956

NOTE 9. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Effective January 1, 2008, DXP adopted authoritative guidance for financial assets and liabilities measured on a recurring basis. This authoritative guidance 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 interest rate swap to which the Company was a party until January 11, 2010, 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 3 liabilities for the three months ended March 31, 2011 and 2010 (in thousands):

	Interest Rate Swap	
	2011	2010
Three Months Ended March 31		
Fair value at January 1	-	\$ (42)
Realized and unrealized gains (losses) included in other comprehensive income	-	42
Fair value at March 31	-	\$ -

To hedge a portion of our floating rate debt, as of January 10, 2008, DXP entered into an interest rate swap agreement with the lead bank of our credit facility. Through January 11, 2010, this interest rate swap effectively fixed the interest rate on \$40 million of floating rate LIBOR borrowings under the Facility at one-month LIBOR of 3.68% plus the margin in effect under our credit facility. This swap was designated as a cash flow hedging instrument. Changes in the fair value of the swap were included in other comprehensive income. At December 31, 2010 and March 31, 2011, the accumulated derivative loss, net of income taxes, was zero.

NOTE 10: ACQUISITIONS

On April 1, 2010, DXP acquired substantially all of the assets of Quadna, Inc ("Quadna"). On December 1, 2010, DXP acquired substantially all of the assets of D&F Distributors, Inc. ("D&F"). The pro-forma results of operations for the Company on a consolidated basis for the three months ended March 31, 2010 assuming the purchases were completed as of January 1, 2010 follows (in thousands, except per share data):

	Three Months Ended March 31, 2010
Net sales	\$ 165,440

Net income	4,304
Per share data	
Basic earnings	\$0.33
D i l u t e d earnings	\$0.32

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.

ITEM 2: MANagements 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”, “planned”, “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. 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 March 31,			
	2011	%	2010	%
	(in thousands, except percentages and per share amounts)			
Sales	\$ 183,087	100.0	\$ 146,992	100.0
Cost of sales	130,660	71.4	105,037	71.5
Gross profit	52,427	28.6	41,955	28.5
Selling, general and administrative expense	40,885	22.3	35,208	23.9
Operating income	11,542	6.3	6,747	4.6
Interest expense	(1,022)	(0.5)	(994)	(0.7)
Other income	21	-	203	0.1
Income before income taxes	10,541	5.8	5,956	4.0
Provision for income taxes	4,198	2.3	2,364	1.6
Net income	\$ 6,343	3.5	\$ 3,592	2.4
Per share amounts				
Basic earnings per share	\$ 0.44		\$ 0.27	
Diluted earnings per share	\$ 0.42		\$ 0.26	

Three Months Ended March 31, 2011 compared to Three Months Ended March 31, 2010

SALES. Sales for the quarter ended March 31, 2011 increased \$36.1 million, or 24.6%, to approximately \$183.1 million from \$147.0 million for the same period in 2010. Sales by Quadna, acquired April 1, 2010, and D&F, acquired December 1, 2010, accounted for \$18.7 million of 2011 sales. Excluding Quadna and D&F sales, sales for 2011 increased 11.8% from 2010. Sales for the Service Centers segment increased \$28.3 million, or 27.4%. Excluding Quadna and D&F 2011 Service Centers segment sales of \$15.4 million, Service Centers segment sales for 2011 increased 12.4% from 2010. This sales increase is primarily due to improvement in the U.S. economy. Sales for the

Supply Chain Services segment increased by \$3.4 million, or 10.9%, for the current quarter when compared to the same period in 2010. The sales increase partially resulted from sales to customers which had been added since the first quarter of 2010. Sales for the Innovative Pumping Solutions segment increased by \$4.4 million, or 35.9%, for the current quarter when compared to the same period in 2010. Excluding Quadna IPS sales of \$3.3 million for 2011, IPS segment sales for 2011 increased 9.0% from 2010. The sales increase resulted from the improvement in the economy and the associated increase in capital spending by our customers.

GROSS PROFIT. Gross profit as a percentage of sales increased to 28.6% for the first quarter of 2011, compared to 28.5% for the same period in 2010. This increase is primarily the result of product mix.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative expense for the quarter ended March 31, 2011 increased by approximately \$5.7 million when compared to the same period in 2010. The majority of the increase relates to \$3.8 million of selling, general and administrative expense for Quadna and D&F for 2011. Excluding Quadna and D&F expenses, the increase primarily resulted from increased salaries, incentive compensation, employee benefits and travel expenses compared to 2010. As a percentage of revenue, the 2011 expense decreased to 22.3%, from 23.9% for the quarter ended March 31, 2010.

OPERATING INCOME. Operating income for the first three months of 2011 increased 71.1% compared to the same period in 2010. Operating income for the Service Centers segment increased 72.9% as a result of increased sales. Operating income for the Supply Chain Services segment decreased 11.4% primarily as a result of lower gross profit margins in the first quarter of 2011 compared to 2010. The lower gross profit margins are primarily the result of termination fees paid by a former customer in the first quarter of 2010. Operating income for the Innovative Pumping Solutions segment increased 16.1% as a result of the 35.9% increase in sales.

INTEREST EXPENSE. Interest expense for the quarter ended March 31, 2011 was almost the same as for the same period in 2010.

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 and warehouse equipment. We also require cash to pay our lease obligations and to service our debt.

We generated \$7.7 million of cash in operating activities during the first three months of 2011 as compared to generating \$5.8 million during the first three months of 2010. This change between the two periods was primarily attributable to the \$2.8 million increase in net income in the 2011 period compared to the 2010 period.

During the first three months of 2011, the amount available to be borrowed under our credit agreement with our bank lender (the "Facility") increased from \$50.0 million at December 31, 2010 to \$62.8 million at March 31, 2011. This increase in availability primarily resulted from the increase in accounts receivable and inventories which increased the amount available under the asset test.

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. The Facility consists of a \$50 million term loan and a revolving credit facility that provides a \$150 million line of credit to the Company. The term loan requires principal payments of \$2.5 million per quarter beginning on December 31, 2008. The Facility matures on August 11, 2013. 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 and certain month ends for the asset test. The asset test is defined under the Facility as the sum of 85% of the Company's net accounts receivable, 60% 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 is \$150 million less borrowings under the revolving credit portion of the facility and letters of credit outstanding, subject to the asset test described above.

On March 31, 2011, the LIBOR based rate on the revolving credit portion of the Facility was LIBOR plus 2.5%, the prime based rate on the revolving credit portion of the Facility was prime plus 1.5%, the commitment fee was 0.375%, the LIBOR based rate for the term loan was LIBOR plus 3.0% and the prime based rate for the term loan was prime plus 2.00%. At March 31, 2011, \$105.0 million was borrowed under the Facility at a weighted average interest rate of approximately 2.9% under the LIBOR options. The revolving credit portion of the Facility provides the option of interest at LIBOR plus a margin ranging from 2.25% to 4.00% or prime plus a margin of 1.25% to 3.00%. Commitment fees of 0.25% to 0.625% per annum are payable on the portion of the Facility capacity not in use for borrowings or letters of credit at any given time. The term loan provides the option of interest at LIBOR plus a margin ranging from 2.75% to 4.50% or prime plus a margin of 1.75% to 3.50%. Borrowings under the Facility are secured by all of the Company's accounts receivable, inventory, general intangibles and non real estate property and equipment. At March 31, 2011, we had \$62.8 million available for borrowing under the Facility.

The Facility's principal financial covenants include:

Fixed Charge Coverage Ratio –The Facility requires 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, minus 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.

Leverage Ratio – The Facility requires that the Company's Leverage Ratio, determined at the end of each fiscal quarter, not exceed 3.50 to 1.0 as of March 31, 2011 and 3.25 to 1.0 as of the last day of each quarter thereafter. The Leverage Ratio is defined as the outstanding Indebtedness divided by EBITDA for the 12 months then ended. At March 31, 2011, the Company's Leverage Ratio was 2.05 to 1.00. The Facility requires that the Company's Senior Leverage Ratio, determined at the end of each fiscal quarter, not exceed 3.00 to 1.00 as of March 31, 2011 and 2.75 to 1.0 as of the last day of each fiscal quarter thereafter. The Senior Leverage Ratio is defined as the outstanding Indebtedness, minus the aggregate amount of all Subordinated Debt, divided by EBITDA for the 12 months then ended. At March 31, 2011, the Company's Senior Leverage Ratio was 2.00 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. Subordinated Debt is defined under the Facility for financial covenant purposes as Indebtedness which has been subordinated on terms and conditions satisfactory to the Lenders.

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The following are computations of the Leverage Ratio and the Senior Leverage Ratio as of March 31, 2011 (in thousands, except for ratios):

For the Twelve Months ended March 31, 2011	Senior Leverage Ratio	Leverage Ratio
Income before taxes	\$36,717	\$36,717
Interest expense	5,236	5,236
Depreciation and amortization	9,737	9,737
Stock compensation expense	1,001	1,001
P r o f o r m a a c q u i s i t i o n EBITDA	1,873	1,873
Reduction of closed locations accrual	(555)	(555)
(A) D e f i n e d EBITDA	\$54,009	\$54,009
As of March 31, 2011		
Total long-term debt	\$109,822	\$109,822
Letters of credit outstanding	933	933
Less: Subordinated Debt	(2,755)	-
D e f i n e d Indebtedness	\$108,000(B)	\$110,755(C)
Senior Leverage Ratio (B)/(A)	2.00	
Leverage Ratio (C)/(A)		2.05

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, or 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 this 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.

Borrowings

	March 31, 2011	December 31, 2010	Increase (Decrease)
(in Thousands)			
Current portion of \$ long-term debt	10,925	\$ 10,930	\$ (5)
Long-term debt, less current portion	98,897	103,621	(4,724)
Total long-term debt	\$ 109,822	\$ 114,551	\$ (4,729)(2)
Amount available	\$ 62,774(1)	\$ 50,020(1)	\$ 12,754 (3)

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

(2) The funds used to reduce debt were obtained from operations.

(3) The \$12.8 million increase in the amount available is primarily a result of the increase in accounts receivable and inventories which increased the amount available under the asset test.

Performance Metrics

	March 31, 2011	March 31, 2010	Increase (Decrease)
Days of sales outstanding	55.9	52.7	3.2
Inventory turns	6.7	6.1	0.6

Accounts receivable days of sales outstanding were 55.9 days at March 31, 2011 compared to 52.7 days at March 31, 2010. The increase resulted primarily from a change in customer mix which resulted in slower collection of accounts receivable. Annualized inventory turns were 6.7 at March 31, 2011 and 6.1 at March 31, 2010. The increase in inventory turns resulted from the increase in sales.

Funding Commitments

We believe our cash generated from operations and available under our Credit 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.

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. 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, 2010 and March 31, 2011 was approximately \$1.8 million and \$1.9 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. We review the carrying value of the net assets of each reporting unit to the net present value of estimated discounted future cash flows of the reporting unit. If the carrying value exceeds the net present value of estimated discounted future cash flows, an impairment indicator exists and an estimate of the impairment loss is calculated. The fair value calculation includes multiple assumptions and estimates, including the projected cash flows and discount rates applied. Changes in these assumptions and estimates could result in goodwill impairment that could materially adversely impact our financial position or results of operations. Assets, liabilities, deferred taxes and goodwill for each reporting unit are determined using the balance sheets maintained for each reporting unit.

When estimating fair values of a reporting unit for our goodwill impairment test, we use an income approach which incorporates management's views. The income approach provides an estimated fair value based on each reporting unit's anticipated cash flows that are discounted using a weighted average cost of capital rate. The primary assumptions used in the income approach are estimated cash flows and weighted average cost of capital. Estimated cash flows are primarily based on projected revenues, operating costs and capital expenditures and are discounted based on comparable industry average rates for weighted average cost of capital.

Long-lived assets, including property, plant and equipment and amortizable intangible assets, also 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 management believes impairment indicators may exist, projections of the undiscounted future cash flows associated with the use of and eventual disposition of long-lived assets held for use are prepared. If the projections indicate that the carrying values of the long-lived assets are not recoverable, we reduce the carrying values to fair value. For long-lived assets held for sale, we compare the carrying values to an estimate of fair value less selling costs to determine potential impairment. We test for impairment of long-lived assets at the lowest level for which cash flows are measurable. These impairment tests are heavily influenced by assumptions and estimates that are subject to change as additional information becomes available.

Purchase Accounting

The Company estimates the fair value of assets, including property, machinery and equipment and their related useful lives and salvage values, 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 March 31, 2011, a 100 basis point change in interest rates would result in approximately a \$1,052,000 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 March 31, 2011) 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, 2010.

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).
- 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. (Filed herewith).
- 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. (Filed herewith).
- 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. (Filed herewith).
- 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. (Filed herewith).

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

Dated: May 4, 2011

