

DXP ENTERPRISES INC  
Form 10-Q  
November 06, 2018

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 September 30, 2018

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

Commission file number 0-21513  
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  
(Address of principal executive offices, including zip code)

(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, every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Emerging growth company

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

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

Number of shares of registrant's Common Stock outstanding as of October 31, 2018: 17,570,252 par value \$0.01 per share.

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PART I: FINANCIAL INFORMATION  
ITEM 1: FINANCIAL STATEMENTS

DXP ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE OPERATIONS

(in thousands, except per share amounts) (unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Sales	\$308,028	\$251,930	\$905,191	\$741,155
Cost of sales	223,958	184,967	659,560	540,741
Gross profit	84,070	66,963	245,631	200,414
Selling, general and administrative expenses	67,257	60,453	197,609	175,411
Income from operations	16,813	6,510	48,022	25,003
Other expense (income), net	120	(153)	(1,318)	(324)
Interest expense	4,781	4,928	15,959	12,573
Income before income taxes	11,912	1,735	33,381	12,754
Provision for income taxes (benefit)	3,550	(1,176)	8,962	2,880
Net income	8,362	2,911	24,419	9,874
Net loss attributable to noncontrolling interest	(35)	(55)	(91)	(360)
Net income attributable to DXP Enterprises, Inc.	8,397	2,966	24,510	10,234
Preferred stock dividend	23	23	68	68
Net income attributable to common shareholders	\$8,374	\$2,943	\$24,442	\$10,166
Net income	\$8,362	\$2,911	\$24,419	\$9,874
Cumulative translation adjustment	3,390	830	1,880	(1,035)
Comprehensive income	\$11,752	\$3,741	\$26,299	\$8,839
Earnings per share :				
Basic	\$0.48	\$0.17	\$1.39	\$0.58
Diluted	\$0.46	\$0.16	\$1.33	\$0.56
Weighted average common shares outstanding :				
Basic	17,564	17,394	17,547	17,402
Diluted	18,404	18,234	18,387	18,242

The accompanying notes are an integral part of these condensed consolidated financial statements.

DXP ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands, except share and per share data)(unaudited)

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash	\$ 15,994	\$ 22,047
Restricted cash	396	3,532
Accounts Receivable, net of allowance for doubtful accounts of \$11,830 and \$9,015	183,454	167,272
Inventories	116,545	91,413
Costs and estimated profits in excess of billings	38,432	26,915
Prepaid expenses and other current assets	5,640	5,296
Federal income taxes receivable	1,323	1,440
Total current assets	361,784	317,915
Property and equipment, net	52,617	53,337
Goodwill	194,052	187,591
Other intangible assets, net	71,783	78,525
Other long-term assets	1,596	1,715
Total assets	\$ 681,832	\$ 639,083
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 3,394	\$ 3,381
Trade accounts payable	91,117	80,303
Accrued wages and benefits	16,733	18,483
Customer advances	2,876	2,189
Billings in excess of costs and estimated profits	5,554	4,249
Other current liabilities	16,703	16,220
Total current liabilities	136,377	124,825
Long-term debt, net of unamortized debt issuance costs	237,434	238,643
Other long-term liabilities	2,611	—
Deferred income taxes	8,048	7,069
Total long-term liabilities	248,093	245,712
Total liabilities	384,470	370,537
Commitments and contingencies ( Note 13)		
Equity:		
Series A preferred stock, \$1.00 par value; 1,000,000 shares authorized	1	1
Series B convertible preferred stock, \$1.00 par value; 1,000,000 shares authorized	15	15
Common stock, \$0.01 par value, 100,000,000 shares authorized; 17,570,252 and 17,315,573 outstanding	174	174
Additional paid-in capital	155,671	153,087
Retained earnings	158,635	134,193
Accumulated other comprehensive loss	(17,611)	(19,491)
Total DXP Enterprises, Inc. equity	296,885	267,979
Noncontrolling interest	477	567
Total equity	297,362	268,546
Total liabilities and equity	\$ 681,832	\$ 639,083

The accompanying notes are an integral part of these condensed consolidated financial statements.



DXP ENTERPRISES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands) (unaudited)

	Nine Months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income attributable to DXP Enterprises, Inc.	\$24,510	\$10,234
Less net loss attributable to non-controlling interest	(91 )	(360 )
Net income	24,419	9,874
Reconciliation of net income to the net cash provided by operating activities:		
Gain on sale of building	(1,318 )	—
Depreciation	7,135	7,655
Amortization of intangible assets	12,575	12,943
Bad debt expense	2,633	1,466
Amortization of debt issuance costs	1,337	1,071
Write-off of debt issuance costs	60	578
Stock compensation expense	2,023	1,392
Deferred income taxes	240	2,000
Changes in operating assets and liabilities		
Trade accounts receivable	(13,225 )	(16,397 )
Costs and estimated profits in excess of billings	(11,541 )	(5,701 )
Inventories	(22,468 )	(3,827 )
Prepaid expenses and other assets	(250 )	(2,362 )
Trade accounts payable and accrued expenses	4,291	(354 )
Billings in excess of costs and estimated profits	1,320	189
Other long-term liabilities	2,611	—
Net cash provided by operating activities	9,842	8,527
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(7,705 )	(2,157 )
Proceeds from the sale of fixed assets	2,546	—
Acquisition of business, net of cash acquired	(10,812 )	—
Net cash used in investing activities	(15,971 )	(2,157 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from debt	—	728,822
Principal debt payments	(2,534 )	(701,561)
Debt issuance costs	(60 )	(11,188 )
Loss for non-controlling interest owners, net of tax	—	(219 )
Dividends paid	(68 )	(68 )
Payment for employee taxes withheld from stock awards	(332 )	(848 )
Net cash (used in) provided by financing activities	(2,994 )	14,938
Effect of foreign currency on cash	(66 )	189
Net change in cash	(9,189 )	21,497
Cash at beginning of period	25,579	1,590
Cash at end of period	\$16,390	\$23,087



The accompanying notes are an integral part of these condensed consolidated financial statements.

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DXP ENTERPRISES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - THE COMPANY

DXP Enterprises, Inc. together with its subsidiaries (collectively "DXP," "Company," "us," "we," or "our") was incorporated in Texas on July 26, 1996. DXP Enterprises, Inc. and its subsidiaries are engaged in the business of distributing maintenance, repair and operating ("MRO") products, and service to energy and industrial customers. Additionally, DXP provides integrated, custom pump skid packages, pump remanufacturing and manufactures branded private label pumps to energy and industrial customers. The Company is organized into three business segments: Service Centers ("SC"), Supply Chain Services ("SCS") and Innovative Pumping Solutions ("IPS"). See Note 15 - Segment Reporting for discussion of the business segments.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING AND BUSINESS POLICIES

Basis of Presentation

The Company's financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"). The accompanying condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and its variable interest entity ("VIE"). The accompanying unaudited condensed consolidated financial statements have been prepared on substantially the same basis as our annual consolidated financial statements and should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2017. For a more complete discussion of our significant accounting policies and business practices, refer to the consolidated annual report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2018. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of results expected for the full fiscal year. In the opinion of management, these condensed consolidated financial statements contain all adjustments necessary to present fairly the Company's condensed consolidated balance sheets as of December 31, 2017 and September 30, 2018, condensed consolidated statements of operations and comprehensive operations for the three and nine months ended September 30, 2018 and September 30, 2017, and condensed consolidated statements of cash flows for the nine months ended September 30, 2018 and September 30, 2017. All such adjustments represent normal recurring items.

All intercompany accounts and transactions have been eliminated upon consolidation.

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncements

Compensation - Stock Compensation. In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. An entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments in this ASU are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted. The amendments in this ASU should be applied prospectively to an award modified on or after the adoption date. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.

Intangibles-Goodwill and Other. In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU is to simplify how an entity is required to test goodwill for impairment. The effective date of the amendment to the standard is for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company adopted this ASU early on December 31, 2017. The Company's annual tests of goodwill for impairment, including qualitative assessments of all of its reporting units' goodwill, determined a quantitative impairment test was not necessary. Therefore the adoption of this standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

Business Combinations. In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. This ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. The effective date of this ASU is for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company

adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements. As discussed in Note 14 - Business Acquisitions, the Company acquired Application Specialties, Inc. in January 2018. Application Specialties, Inc. met the definition of a business under the new guidance and goodwill was recorded.

**Statement of Cash Flows.** In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments. This ASU addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The effective date of the amendment to the standard is for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.

**Financial Instruments.** In January 2016, the FASB issued ASU 2016-01, Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities. This change to the financial instrument model primarily affects the accounting for equity investments, financial liabilities under fair value options and the presentation and disclosure requirements for financial instruments. The effective date for the standard is for fiscal years and interim periods within those years beginning after December 15, 2017. Certain provisions of the new guidance can be adopted early. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Financial Statements.

**Revenue Recognition.** In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance on revenue recognition. The core principal of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance requires entities to apply a five-step method to (1) identify the contract(s) with customers, (2) identify the performance obligation(s) in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligation(s) in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. This pronouncement, as amended by ASU 2015-14, was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017.

The Company elected the modified retrospective method and adopted the new revenue guidance effective January 1, 2018, with no impact to the opening retained earnings.

Our accounting for contracts with customers under the new revenue recognition standard was consistent with the Company's previous revenue recognition model, whereby revenue is recognized primarily on the date products are shipped to the customer. The ASU also requires expanded qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, significant judgments and accounting policy.

The adoption of the new standard did not have a material impact on the Company's Consolidated Financial Statements. See Note 4 – Revenue Recognition.

#### Accounting Pronouncements Not Yet Adopted

**Intangibles-Goodwill and Other.** In August 2018, the FASB issued ASU No. 2018-15, Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract based on a consensus of the FASB's Emerging Issues Task Force (EITF) that requires implementation costs incurred by customers in cloud computing arrangements (CCAs) to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customer in a software licensing

arrangement under the internal-use software guidance in ASC 350-40, “Intangibles-Goodwill and Other-Internal-Use Software”. The ASU does not affect the accounting by cloud service providers, other software vendors or customers’ accounting for software licensing arrangements. The ASU will require companies to recognize deferred implementation costs to expense over the ‘term of the hosting arrangement’. Under the ASU, the term of the hosting arrangement comprises the noncancellable period of the CCA plus any optional renewal periods that are reasonably certain to be exercised by the customer or for which exercise of the option is controlled by the vendor. The guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, and we will continue to assess the standard and make a determination later.

Fair Value Measurement. In August 2018, the FASB issued ASU 2018-13: Fair Value Measurement: Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement which eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. Entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. The guidance is effective for all entities for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years, but entities are permitted to early adopt either the entire standard or only the provisions that eliminate

or modify the disclosure requirements. The new standard will not have an impact on our results of operations, but it will significantly modify our disclosures around fair value measurements.

**Leases- Targeted Improvements.** In July 2018, the FASB issued ASU No. 2018-11, Leases: Targeted Improvements (Topic 842). ASU 2018-11 provides additional relief in the comparative reporting requirements for initial adoption of ASC 842 as described below. Under ASU 2018-11, adopters will take a prospective approach, rather than a retrospective approach as initially prescribed, when transitioning to ASU 2016-02. Instead of recording the cumulative impact of all comparative reporting periods presented within retained earnings, adopters will now assess the facts and circumstances of all leasing contracts as of January 1, 2019 (for public companies with calendar year-end reporting dates) and January 1, 2020 (for non-public companies with calendar year-end reporting dates). We intend to apply this adoption approach for our transition January 1, 2019.

**Financial Instruments – Credit Losses.** In June 2016, the FASB issued ASU 2016-13: Financial Instruments – Credit Losses, which replaces the incurred loss impairment methodology in current US GAAP with a methodology that reflects expected credit losses. The update is intended to provide financial statement users with more useful information about expected credit losses. The amended guidance is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. We are currently evaluating the effect, if any, that the guidance will have on the Company's Consolidated Financial Statements and related disclosures.

**Leases.** In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The update requires organizations that lease assets ("lessees") to recognize the assets and liabilities for the rights and obligations created by leases with terms of more than 12 months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee remains dependent on its classification as a finance or operating lease. The criteria for determining whether a lease is a finance or operating lease has not been significantly changed by this ASU. The ASU also requires additional disclosure of the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. This pronouncement is effective for financial statements issued for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently undergoing the implementation process for the new standard. We intend to apply most of the practical expedients and we have elected to apply the current period transition approach as introduced by ASU 2018-11. We expect the new standard to have a significant effect on our consolidated balance sheet by adding ROU assets and the corresponding lease liabilities for our inventory of operating leases. We do not expect the new standard to have a material impact on our results of operations.

#### NOTE 4 – REVENUE RECOGNITION

In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers, and issued subsequent amendments to the initial guidance in August 2015, March 2016, April 2016, May 2016, and December 2016 within ASU 2015-14, ASU 2016-8, ASU 2016-10, ASU 2016-12 and ASU 2016-20, respectively. The core principle of this new revenue recognition guidance is that a company will recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance defines a five-step process to achieve this core principle. The new guidance also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance provided for two transition methods, a full retrospective approach and a modified retrospective approach.

On January 1, 2018, the Company adopted ASC Topic 606 using the modified retrospective method with no impact to the opening retained earnings and determined there were no changes required to its reported revenues as a result of the adoption. The Company has enhanced its disclosures of revenue to comply with the new guidance.

Results for reporting periods beginning after January 1, 2018 are presented under ASC Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with ASC Topic 605, "Revenue Recognition."

#### Overview

The Company's primary source of revenue is the sale of products, and service to energy and industrial customers. The Company is organized into three business segments: Service Centers, Supply Chain Services and Innovative Pumping Solutions.

The Service Centers segment provides a wide range of maintenance, repair and operating (MRO) products, equipment and integrated services, including logistics capabilities, to industrial customers. Revenue is recognized upon the completion of our performance obligation(s) under the sales agreement. The majority of the Service Centers segment revenue originates from the satisfaction of a single performance obligation, the delivery of products. Revenues are recognized when an agreement is in place, the performance obligations under the contract have been identified, and the price or consideration to be received is fixed and allocated to the

performance obligation(s) in the contract. We believe our performance obligation has been satisfied when title passes to the customer or services have been rendered under the contract. Revenues are recorded net of sales taxes.

The Company fabricates and assembles custom-made pump packages, remanufactures pumps and manufactures branded private label pumps within our Innovative Pumping Solutions segment. For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues over time when the customer is able to direct the use of and obtain substantially all of the benefits of the work performed. This typically occurs when the products have no alternative use for us and we have a right to payment for the work completed to date plus a reasonable profit margin. Contracts generally include cancellation provisions that require the customer to reimburse us for costs incurred through the date of cancellation. We recognize revenue for these contracts using the percentage of completion method, an "input method" as defined by the new standard. 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. The typical time span of these contracts is approximately three to eighteen months.

The Supply Chain Services segment provides a wide range of MRO products and manages all or part of a customer's supply chain, including warehouse and inventory management. Like the Service Centers segment above, revenue for the Supply Chain Services segment is recognized upon the completion of performance obligations. Revenues are recognized when an agreement or contract is in place and the price is fixed followed by execution of our performance obligations. We generally consider the satisfaction of our performance obligation has occurred when title for product passes to the customer or services have been rendered. Revenues are recorded net of sales taxes.

See Note 15 - Segment Reporting for disaggregation of revenue by reporting segments. The Company believes this disaggregation best depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

#### NOTE 5 - 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

Level 1 inputs come from quoted prices (unadjusted) in active markets for identical assets or liabilities.

##### Level 2 Inputs

Level 2 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

Level 3 inputs 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.

Our acquisitions may include contingent consideration as part of the purchase price. The fair value of the contingent consideration is estimated as of the acquisition date based on the present value of the contingent payments to be made using a weighted probability of possible payments. The unobservable inputs used in the determination of the fair value of the contingent consideration include managements assumptions about the likelihood of payment based on the established benchmarks and discount rates based on an internal rate of return analysis. The fair value measurement includes inputs that are Level 3 measurement as discussed above, as they are not observable in the market. Should actual results increase or decrease as compared to the assumption used in our analysis, the fair value of the contingent consideration obligations will increase or decrease, up to the contracted limit, as applicable. Changes in the fair value of the contingent earn-out consideration are measured each reporting period and reflected in our results of operations.

As of September 30, 2018, we recorded a \$4.1 million liability for contingent consideration associated with the acquisition of ASI in other current and long-term liabilities. See further discussion at Note 14 "Business Acquisitions".

For the Company's assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the following table provides a reconciliation of the beginning and ending balances for each category therein, and gains or losses recognized during the nine months ended September 30, 2018:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	Contingent Liability for Accrued Consideration (in thousands)
Beginning balance at January 1, 2018	\$ —
Acquisitions and settlements	
Acquisition of ASI (Note 14)	4,214
Settlements	—
Total remeasurement adjustments:	
(Gains) or losses recorded against goodwill	(208 )
Changes in fair value recorded in profit and loss	78
Ending Balance at September 30, 2018	\$ 4,084

The amount of total (gains) or losses for the year included in earnings or changes to net assets, attributable to changes in unrealized (gains) or losses relating to assets or liabilities still held at year-end. \$ —

\* Included in other current and long-term liabilities

Quantitative Information about Level 3 Fair Value Measurements

The significant unobservable inputs used in the fair value measurement of the Company's contingent consideration liabilities designated as Level 3 are as follows:

(in thousands, unaudited)	Fair value at September 30, 2018	Valuation Technique	Significant Unobservable Inputs
Contingent consideration: (ASI acquisition)	\$ 4,084	Discounted cash flow	Annualized EBITDA and probability of achievement

Sensitivity to Changes in Significant Unobservable Inputs

As presented in the table above, the significant unobservable inputs used in the fair value measurement of contingent consideration related to the acquisition of ASI are annualized EBITDA forecasts developed by the Company's management and the probability of achievement of those EBITDA results. The discount rate used in the calculation was 7.6%. Significant increases (decreases) in these unobservable inputs in isolation would result in a significantly (lower) higher fair value measurement.

Other financial instruments not measured at fair value on the Company's unaudited condensed consolidated balance sheet at September 30, 2018 but which require disclosure of their fair values include: cash and cash equivalents, trade accounts receivable, trade accounts payable and accrued expenses, accrued payroll and related benefits, and the revolving line of credit and term loan debt under our syndicated credit agreement facility. The Company believes that

the estimated fair value of such instruments at September 30, 2018 and December 31, 2017 approximates their carrying value as reported on the unaudited Condensed Consolidated Balance Sheets.

## NOTE 6 – INVENTORIES

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

	September 30, December 31,	
	2018	2017
Finished goods	\$ 101,227	\$ 79,820
Work in process	15,318	11,593
Inventories	\$ 116,545	\$ 91,413

## NOTE 7 – COSTS AND ESTIMATED PROFITS ON UNCOMPLETED CONTRACTS

Costs and estimated profits in excess of billings on uncompleted contracts arise in the consolidated balance sheets when revenues have been recognized but the amounts cannot be billed under the terms of the contracts. Such amounts are recoverable from customers upon various measures of performance, including achievement of certain milestones, completion of specified units, or completion of a contract.

Costs and estimated profits on uncompleted contracts and related amounts billed were as follows ( in thousands):

	September 30, December 31,	
	2018	2017
Costs incurred on uncompleted contracts	\$ 57,655	\$ 37,899
Estimated profits, thereon	7,448	2,665
Total	65,103	40,564
Less: billings to date	32,219	17,881
Net	\$ 32,884	\$ 22,683

Such amounts were included in the accompanying Condensed Consolidated Balance Sheets for 2018 and 2017 under the following captions ( in thousands):

	September December 31,	
	30, 2018	2017
Costs and estimated profits in excess of billings	\$ 38,432	\$ 26,915
Billings in excess of costs and estimated profits	(5,554 )	(4,249 )
Translation adjustment	6	17
Net	\$ 32,884	\$ 22,683

## NOTE 8 - GOODWILL AND OTHER INTANGIBLE ASSETS

The following table presents the changes in the carrying amount of goodwill and other intangible assets during the nine months ended September 30, 2018 ( in thousands):

	Goodwill	Other Intangible Assets	Total
Balance as of December 31, 2017	\$ 187,591	\$ 78,525	\$ 266,116
Acquired during the period	6,461	6,185	12,646
Translation adjustment	—	(352 )	(352 )
Amortization	—	(12,575 )	(12,575 )
Balance as of September 30, 2018	\$ 194,052	\$ 71,783	\$ 265,835



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The following table presents the goodwill balance by reportable segment as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018	December 31, 2017
Service Centers	\$ 160,934	\$ 154,473
Innovative Pumping Solutions	15,980	15,980
Supply Chain Services	17,138	17,138
Total	\$ 194,052	\$ 187,591

The following table presents a summary of amortizable other intangible assets ( in thousands):

	September 30, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Carrying Amount, net	Gross Carrying Amount	Accumulated Amortization	Carrying Amount, net
Customer relationships	\$ 168,255	\$ (96,639 )	71,616	162,200	(83,806 )	78,394
Non-compete agreements	784	(617 )	167	949	(818 )	131
Total	\$ 169,039	\$ (97,256 )	\$ 71,783	\$ 163,149	\$ (84,624 )	\$ 78,525

Gross carrying amounts as well as accumulated amortization are partially affected by the fluctuation of foreign currency rates. Other intangible assets are amortized according to estimated economic benefits over their estimated useful lives.

#### NOTE 9 – INCOME TAXES

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Tax Cuts and Jobs Act contains several tax law changes that will impact the Company in the current and future periods. The Company is applying the guidance in Staff Accounting Bulletin ("SAB") 118 issued by the Securities and Exchange Commission when accounting for the enactment-date effects of the Tax Cuts and Jobs Act. Specifically, SAB 118 permits companies to record a provisional amount which can be remeasured during the measurement period due to obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enacted date. At September 30, 2018, the Company has not completed our accounting for all of the tax effects of the Tax Cuts and Jobs Act; however, in certain cases, as described below, the Company has made a reasonable estimate of other effects. The Company will finalize its calculations as additional analysis is completed during the fourth quarter.

The Company originally remeasured our U.S. net deferred tax liabilities and recorded a provisional \$1.3 million benefit and a corresponding provisional decrease in the U.S. net deferred tax liability relating to the reduction in the U.S. federal corporate income tax rate to 21% from 35%. We are still in the process of analyzing Tax Cuts and Jobs Act's impact as permitted under SAB 118. The largest impact to the Company being the remeasurement of deferred taxes due to the U.S. statutory tax rate change. The mandatory repatriation and resulting toll charge on accumulated foreign earnings and profits has limited impact on the Company as unremitted earnings from non-US jurisdictions is minimal. The Company is provisional in its approach and assertion that there is no financial statement impact related to mandatory repatriation as of September 30, 2018. We will continue to monitor tax reform, as we anticipate additional guidance from the Internal Revenue Service will become more available throughout 2018.

Our effective tax rate from continuing operations was a tax expense of 26.9% for the nine months ended September 30, 2018 compared to a tax expense of 22.6% for the nine months ended September 30, 2017. Compared to the U.S. statutory rate for the nine months ended September 30, 2018, the effective tax rate was increased by state taxes, foreign taxes, and nondeductible expenses and partially offset by research and development tax credits and

other tax credits. Compared to the U.S. statutory rate for the nine months ended September 30, 2017, the effective tax rate was increased by state taxes and nondeductible expenses and partially offset by lower income tax rates on income earned in foreign jurisdictions, domestic production activities deduction, valuation allowance release, and research and development credits.

To the extent penalties and interest would be assessed on any underpayment of income tax, such accrued amounts would be classified as a component of income tax provision (benefit) in the financial statements consistent with the Company's policy.

## NOTE 10 – LONG-TERM DEBT

The components of the Company's long-term debt consisted of the following ( in thousands):

	September 30, 2018		December 31, 2017	
	Carrying Value*	Fair Value	Carrying Value*	Fair Value
ABL Revolver	\$—	\$—	\$—	\$—
Term Loan B	247,500	249,356	249,375	251,869
Promissory note due January 2021	2,063	2,063	2,722	2,722
Total long-term debt	249,563	251,419	252,097	254,591
Less: current portion	(3,394 )	(3,419 )	(3,381 )	(3,406 )
Long-term debt less current maturities	\$246,169	\$248,000	\$248,716	\$251,185

\*Carrying value amounts do not include unamortized debt issuance costs of \$8.7M and \$10.1 for September 30, 2018 and December 31, 2017, respectively.

The fair value measurements used by the Company are considered Level 2 inputs, as defined in the fair value hierarchy. The fair value estimates were based on quoted prices for identical or similar securities.

## August 2017 Credit Agreements

On August 29, 2017, the Company entered into two credit agreements (the "August 2017 Credit Agreements") that provided for an \$85.0 million asset-backed revolving line of credit (the "ABL Revolver") and a \$250.0 million senior secured term loan B (the "Term Loan B"). Under the ABL Revolver, the Company may request \$10.0 million incremental revolving loan commitments in an additional aggregate amount not to exceed \$50.0 million, subject to pro forma compliance with certain net secured leverage ratio tests.

The applicable rate for the ABL Revolver is LIBOR plus a margin ranging from 1.25% to 1.75% per annum. The applicable rate for the Term Loan B was LIBOR plus 5.50% subject to a LIBOR floor of 1.00%. The maturity date of the ABL Revolver is August 29, 2022 and the maturity date of the Term Loan B is August 29, 2023.

On June 25, 2018, the Company entered into Amendment No. 1 (the "Repricing Amendment") to the Senior Secured Term Loan B Agreement. The Repricing Amendment, among other things, reduced the applicable rate for the term loans to LIBOR plus 4.75% (subject to a LIBOR floor of 1.00%) from LIBOR plus 5.50%. The Repricing Amendment also includes a "soft call" prepayment penalty of 1.0% for a period of six months commencing with the date of the Repricing Amendment for certain prepayments, refinancing, and amendments.

The Company accounted for the Repricing Amendment as a modification of debt. Approximately, \$60,000 of prior deferred debt issuance costs were accelerated and recorded as additional interest expense in the condensed consolidated statements of operations and comprehensive operations, attributable to prior syndicate lenders who reduced or eliminated their positions during the amendment process. The Company also incurred \$0.9 million of third party fees in connection with the Repricing Amendment, which was also recorded as additional interest expense in the condensed consolidated statements of operations and comprehensive operations.

As of September 30, 2018, the Company had no amount outstanding under the ABL Revolver and had \$79.9 million of borrowing capacity, including the impact of letters of credit.





## Interest on Borrowings

The interest rates on our borrowings outstanding at September 30, 2018 and December 31, 2017, including the amortization of debt issuance costs, were as follows:

	September		December	
	30, 2018		31, 2017	
ABL Revolver	4.0	%	2.9	%
Term Loan B	7.0	%	7.1	%
Promissory Note	2.9	%	2.9	%
Weighted average interest rate	7.0	%	7.0	%

The Company was in compliance with all financial covenants under the August 2017 Credit Agreements as of September 30, 2018.

## NOTE 11 - STOCK-BASED COMPENSATION

## Restricted Stock

Under the equity incentive plans approved by our shareholders, directors, consultants and employees may be awarded shares of DXP's common stock. The shares of restricted stock and restricted stock units granted to employees and that are outstanding as of September 30, 2018 vest (or have forfeiture restrictions that lapse) in accordance with one of the following vesting schedules: 100% one year after date of grant; 50% each year for two years after date of grant; 33.3% each year for three years after date of grant; 20% each year for five years after date of grant; or 10% each year for ten years after date of grant. 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. Shares of our common stock are issued and outstanding upon the grant of awards of restricted stock. Once restricted stock units vest, new shares of the Company's stock are issued. At September 30, 2018, 272,510 shares were available for future grant.

Changes in restricted stock for the nine months ended September 30, 2018 were as follows:

	Number of Shares	Weighted Average Grant Price
Non-vested at December 31, 2017	77,901	\$ 30.36
Granted	131,113	\$ 31.90
Forfeited	(2,400 )	\$ 46.68
Vested	(37,621 )	\$ 31.68
Non-vested at September 30, 2018	168,993	\$ 31.03

Compensation expense, associated with restricted stock, recognized in the nine months ended September 30, 2018 and 2017 was \$1.5 million and \$1.4 million, respectively. Related income tax benefits recognized in earnings for the nine months ended September 30, 2018 and 2017 were approximately \$0.4 million and \$0.6 million. Unrecognized compensation expense under the Restricted Stock Plan at September 30, 2018 and December 31, 2017 was \$4.1 million and \$1.6 million, respectively. As of September 30, 2018, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 23.5 months.

NOTE 12 - EARNINGS PER SHARE DATA

Basic earnings per share is computed based on weighted average shares outstanding and excludes dilutive securities. Diluted earnings per share is computed including the impacts of all potentially dilutive securities.

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated ( in thousands, except per share data):

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	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>Basic:</b>				
Weighted average shares outstanding	17,564	17,394	17,547	17,402
Net income attributable to DXP Enterprises, Inc.	\$8,397	\$2,966	\$24,510	\$10,234
Convertible preferred stock dividend	23	23	68	68
Net income attributable to common shareholders	\$8,374	\$2,943	\$24,442	\$10,166
Per share amount	\$0.48	\$0.17	\$1.39	\$0.58
<b>Diluted:</b>				
Weighted average shares outstanding	17,564	17,394	17,547	17,402
Assumed conversion of convertible preferred stock	840	840	840	840
Total dilutive shares	18,404	18,234	18,387	18,242
Net income attributable to common shareholders	\$8,374	\$2,943	\$24,442	\$10,166
Convertible preferred stock dividend	23	23	68	68
Net income attributable to DXP Enterprises, Inc.	\$8,397	\$2,966	\$24,510	\$10,234
Per share amount	\$0.46	\$0.16	\$1.33	\$0.56

#### Series A Preferred Stock

The holders of Series A preferred stock are entitled to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of common stock, and are not entitled to any dividends or distributions other than in the event of a liquidation of the Company, in which case the holders of the Series A preferred stock are entitled to a \$100 liquidation preference per share. At September 30, 2018, 1,122 shares of Series A Preferred Stock were issued and outstanding.

#### Series B Preferred Stock

Each share of the Series B convertible preferred stock is convertible into 56 shares of common stock and a monthly dividend per share of \$.50. The holders of the Series B convertible stock are also entitled to a \$100 liquidation preference per share after payment of the distributions to the holders of the Series A preferred stock and to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of the common stock. At September 30, 2018, 15,000 shares of Series B Preferred Stock were issued and outstanding.

#### NOTE 13 - COMMITMENTS AND CONTINGENCIES

From time to time, the Company is a party to various legal proceedings arising in the ordinary course of business. While DXP is unable to predict the outcome of these lawsuits, it believes that the ultimate resolution will not have, either individually or in the aggregate, a material adverse effect on DXP's consolidated financial position, cash flows, or results of operations.

#### NOTE 14 – BUSINESS ACQUISITIONS

On January 1, 2018, the Company completed the acquisition of Application Specialties, Inc. ("ASI"), a distributor of cutting tools, abrasives, coolants and machine shop supplies. The Company paid approximately \$11.7 million in cash and stock. The purchase price also includes approximately \$4.0 million in contingent consideration. The purchase was financed with \$10.8 million of cash on hand as well as issuing \$0.9 million of the Company's common stock. ASI will

provide the Company's metal working division with new geographic territory and enhance DXP's end market mix. For the nine months September 30, 2018, ASI contributed sales of \$35.0 million and earnings before taxes of approximately \$4.1 million.

As part of our purchase agreement, we may pay up to an additional \$4.6 million of contingent consideration over the next three years based on the achievement of certain earnings benchmarks established for calendar years 2018, 2019 and 2020. The purchase price includes the estimated fair value of the contingent consideration recorded at the present value of approximately \$4.1 million. The estimated fair value of the contingent consideration was determined using a probability-weighted discounted cash flow model. We determined the fair value of the contingent consideration obligations by calculating the probability-weighted payments based

on our assessment of the likelihood that the benchmarks will be achieved. The probability-weighted payments were then discounted using a discount rate based on an internal rate of return analysis using the probability-weighted cash flows. The fair value measurement includes earnings forecasts which are a Level 3 measurement as discussed in Note 5. The fair value of the contingent consideration is reviewed quarterly over the earn-out period to compare actual earnings before interest, taxes, depreciation and amortization ("EBITDA") achieved to the estimated EBITDA used in our forecasts.

As of September 30, 2018, approximately \$1.5 million of the actual cash due toward the contingent consideration earned is recorded in current liabilities. We may pay up to an additional \$3.1 million over the remaining earn-out period based on the achievement of certain EBITDA benchmarks. The estimated fair value of the contingent consideration is recorded at the present value of \$4.1 million at September 30, 2018. Changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, are reflected in our results of operations in the periods in which they are identified. Changes in the fair value of the contingent consideration may materially impact and cause volatility in our future operating results. Changes in our estimates for the contingent consideration are discussed in Note 5 to our condensed consolidated financial statements.

The total acquisition consideration is equal to the sum of all cash payments, the fair value of stock issued, and the present value of any contingent consideration. The following table summarizes the total acquisition consideration for the ASI Purchase at closing:

Purchase Price Consideration	Total Consideration (in thousands)
Cash payments	\$ 10,792
Fair value of stock issued	894
Present value of estimated fair value of contingent earn-out consideration	4,006
Total purchase price consideration	\$ 15,692

#### NOTE 15 - SEGMENT REPORTING

The Company's reportable business segments are: Service Centers, Innovative Pumping Solutions and Supply Chain Services. The Service Centers segment is engaged in providing maintenance, MRO 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 pump packages, remanufactures pumps and manufactures branded private label pumps. The Supply Chain Services segment provides a wide range of MRO products and manages all or part of a customer's supply chain, including warehouse and inventory management.

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.

The following table sets out financial information related to the Company's segments excluding amortization (in thousands):

Three Months Ended September 30, 2018				2017			
SC	IPS	SCS	Total	SC	IPS	SCS	Total

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Sales	\$187,763	\$76,662	\$43,603	\$308,028	\$160,863	\$51,027	\$40,040	\$251,930
Income from operations	\$20,590	\$8,773	\$3,886	\$33,249	\$15,550	\$1,838	\$3,982	\$21,370

Nine Months Ended

September 30,

2018

2017

	SC	IPS	SCS	Total	SC	IPS	SCS	Total
Sales	\$556,700	\$218,561	\$129,930	\$905,191	\$474,324	\$144,555	\$122,276	\$741,155
Income from operations	\$58,353	\$24,109	\$12,196	\$94,658	\$47,308	\$7,103	\$11,758	\$66,169

The following table presents reconciliations of operating income for reportable segments to the consolidated income before taxes (in thousands):

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Operating income for reportable segments	\$33,249	\$21,370	\$94,658	\$66,169
Adjustment for:				
Amortization of intangible assets	4,098	4,336	12,575	12,943
Corporate expenses	12,338	10,524	34,061	28,223
Income from operations	16,813	6,510	48,022	25,003
Interest expense	4,781	4,928	15,959	12,573
Other (income) expense, net	120	(153 )	(1,318 )	(324 )
Income before income taxes	\$11,912	\$1,735	\$33,381	\$12,754

#### NOTE 16 - SUBSEQUENT EVENTS

We have evaluated subsequent events through the date the interim Condensed Consolidated Financial Statements were issued. There were no subsequent events that required recognition or disclosure unless elsewhere identified in this report.



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

The following management discussion and analysis ("MD&A") of the financial condition and results of operations of DXP Enterprises, Inc. together with its subsidiaries (collectively "DXP," "Company," "us," "we," or "our") for the three and nine months ended September 30, 2018 should be read in conjunction with our previous annual report on Form 10-K and our quarterly reports on Form 10-Q, and the consolidated financial statements and notes thereto included in our annual and quarterly reports. The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

### 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", "might", "estimates", "will", "should", "could", "would", "suspect", "potential", "current", "achieve", "plans" or "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 may involve significant risks and uncertainties, and actual results may vary materially from those discussed in the forward-looking statements or historical performance as a result of various factors. These factors include the effectiveness of management's strategies and decisions, our ability to implement our internal growth and acquisition growth strategies, general economic and business conditions specific to our primary customers, changes in government regulations, our ability to effectively integrate businesses we may acquire, our success in remediating our internal control weaknesses, new or modified statutory or regulatory requirements, availability of materials and labor, inability to obtain or delay in obtaining government or third-party approvals and permits, non-performance by third parties of their contractual obligations, unforeseen hazards such as weather conditions, acts of war or terrorist acts and the governmental or military response thereto, cyber-attacks adversely affecting our operations, other geological, operating and economic considerations and declining prices and market conditions, including reduced oil and gas prices and supply or demand for maintenance, repair and operating products, equipment and service, and our ability to obtain financing on favorable terms or amend our credit facilities as needed. This Report identifies other factors that could cause such differences. We cannot assure that these are all of the factors that could cause actual results to vary materially from the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors", included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2018. 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

(in thousands, except percentages and per share data)

DXP is organized into three business segments: Service Centers ("SC"), Supply Chain Services ("SCS") and Innovative Pumping Solutions ("IPS"). The Service Centers are engaged in providing maintenance, repair and operating ("MRO") products, equipment and integrated services, including technical expertise and logistics capabilities, to industrial customers with the ability to provide same day delivery. The Service Centers provide a wide range of MRO products and services in the rotating equipment, bearing, power transmission, hose, fluid power, metal working, industrial supply and safety product and service categories. The SCS segment provides a wide range of MRO products and manages all or part of our customer's supply chain function, and inventory management. The IPS segment fabricates and assembles integrated pump system packages custom made to customer specifications, remanufactures pumps and manufactures branded private label pumps. Over 90% of DXP's revenues represent sales of products.

	Three Months Ended September 30,			
	2018	%	2017	%
Sales	\$308,028	100.0 %	\$251,930	100.0 %
Cost of sales	223,958	72.7 %	184,967	73.4 %
Gross profit	84,070	27.3 %	66,963	26.6 %
Selling, general and administrative expenses	67,257	21.8 %	60,453	24.0 %
Income from operations	16,813	5.5 %	6,510	2.6 %
Other (income) expense, net	120	— %	(153)	(0.1) %
Interest expense	4,781	1.6 %	4,928	2.0 %
Income before income taxes	11,912	3.9 %	1,735	0.7 %
Provision for income taxes (benefit)	3,550	1.2 %	(1,176)	(0.5) %
Net income	8,362	2.7 %	2,911	1.2 %
Net loss attributable to noncontrolling interest	(35)	) —	(55)	) —
Net income attributable to DXP Enterprises, Inc.	8,397	2.7 %	2,966	1.2 %
Per share amounts attributable to DXP Enterprises, Inc.				
Basic earnings per share	\$0.48		\$0.17	
Diluted earnings per share	\$0.46		\$0.16	

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

**SALES.** Sales for the three months ended September 30, 2018 increased \$56.1 million, or 22.3%, to approximately \$308.0 million from \$251.9 million for the prior year's corresponding period. Sales from a business acquired on January 1, 2018 accounted for \$12.1 million of the increase. Excluding third quarter 2018 sales of the business acquired, sales for the third quarter in 2018 increased by \$44.0 million, or 17.5% from the prior year's corresponding period. This sales increase is the result of an increase in our IPS, SC and SCS segments of \$25.6 million, \$14.8 million and \$3.6 million, respectively, excluding acquisition sales. The fluctuations in sales is further explained in our business segment discussions below.

**Innovative Pumping Solutions segment.** Sales for the IPS segment increased by \$25.6 million, or 50.2% for the three months ended September 30, 2018 compared to the prior year's corresponding period. This increase was primarily the result of an increase in the capital spending by oil and gas producers and related businesses stemming from an increase in the drilling rig count production and the price of oil during the first nine months of 2018. This level of IPS sales might continue, or improve, during the remainder of 2018, if crude oil and natural gas prices and the drilling rig count remain at levels experienced during the first nine months of 2018.

Service Centers segment. Sales for the Service Centers segment increased by \$26.9 million, or 16.7% for the three months ended September 30, 2018 compared to the prior year's corresponding period. Excluding \$12.1 million of third quarter 2018 Service Centers segment sales from a business acquired, Service Centers segment sales for the third quarter in 2018 increased \$14.8 million, or 9.2% from the prior year's corresponding period. This sales increase is primarily the result of increased sales of rotating equipment, bearings and power transmissions and metal working products to customers engaged in the late upstream, midstream or downstream oil and gas markets or manufacturing equipment for these markets in connection with increased capital spending by oil and gas producers. If crude oil and natural gas prices and the drilling rig count remain at levels experienced during the third quarter of 2018, this level of sales to the oil and gas industry might continue, or improve, during the remainder of 2018.

Supply Chain Services segment. Sales for the SCS segment increased by \$3.6 million, or 8.9%, for the three months ended September 30, 2018, compared to the prior year's corresponding period. The increase in sales is primarily related to increased sales to customers in the food and beverage, oil and gas and aerospace industries.

**GROSS PROFIT.** Gross profit as a percentage of sales for the three months ended September 30, 2018 increased by approximately 71 basis points from the prior year's corresponding period. Excluding the impact of the business acquired, gross profit as a percentage of sales increased by approximately 106 basis points. The increase in the gross profit percentage excluding the business acquired, is primarily the result of an approximate 402 basis point increase in the gross profit percentage in our IPS segment partially offset by an approximate 109 basis point decrease in the gross profit percentage in our Supply Chain Services segment. Gross profit for the IPS segment increased as a result of an increase in the capital spending by oil and gas producers and related businesses stemming from an increase in the drilling rig count production and the price of oil during the first nine months of 2018.

Innovative Pumping Solutions segment. As a percentage of sales, the third quarter gross profit percentage for the IPS segment increased approximately 402 basis points from the prior year's corresponding period primarily as a result of an increase in utilization and capacity within IPS' engineered-to-order business and an overall improvement in the pricing environment driven by an increase in capital spending by oil and gas producers. Additionally, gross profit margins for individual orders have continued to improve because of the increase in sales of built to order customer specific products. Operating income for the IPS segment increased \$6.9 million or 377.2%, primarily as a result of the above mentioned increase in sales.

Service Centers segment. As a percentage of sales, the third quarter gross profit percentage for the Service Centers increased approximately 32 basis points and increased approximately 107 basis points, adjusting for the business acquired, from the prior year's corresponding period. This was primarily as a result of sales mix and price increases from vendors. Operating income for the Service Centers segment increased \$5.0 million, or 32.4%. The increase in operating income is primarily the result of the improved sales.

Supply Chain Services segment. Gross profit as a percentage of sales decreased approximately 109 basis points, compared to the prior year's corresponding period. This was primarily as a result of sales mix and contractual lag effects of price increases from vendors. Operating income for the third quarter of 2018 decreased \$0.1 million compared to the prior year's corresponding period mainly due to an increase in SG&A expense of \$0.5 million primarily partially offset by an increase in gross profit of \$0.4 million.

**SELLING, GENERAL AND ADMINISTRATIVE ("SG&A").** Selling, general and administrative expense for the three months ended September 30, 2018 increased by approximately \$6.8 million, or 11.3%, to \$67.3 million from \$60.5 million for the prior year's corresponding period. Selling, general and administrative expense from a business that was acquired accounted for \$0.7 million of the third quarter increase. Excluding expenses from the business that was acquired, SG&A for the quarter increased by \$6.1 million, or 10.1%. The overall increase in SG&A adjusting for the business acquired, is the result of increased payroll, incentive compensation and related taxes and 401(k) expenses primarily due to increased headcount. The remaining increase in SG&A expense for the third quarter of 2018, is a result of the increase in sales. Adjusting for the business acquired, the third quarter 2018 expense decreased 152 basis points to 22.5% from 24.0% for the prior year's corresponding period primarily as a result of the fixed cost leverage nature of SG&A.

**OPERATING INCOME.** Operating income for the third quarter of 2018 increased by \$10.3 million, to \$16.8 million, from \$6.5 million in the prior year's corresponding period. The operating income from the business acquired in 2018 increased the overall operating income for the three months ended September 30, 2018 by \$1.5 million. Excluding the operating income from the business acquired, operating income increased \$8.8 million, or 134.5% from the prior year's corresponding period. This increase in operating income is primarily related to the increase in sales discussed

above.

**INTEREST EXPENSE.** Interest expense for the third quarter of 2018 decreased 3.0% from the prior year's corresponding period primarily as a result of decreased interest cost compared to rates under a prior credit facility.

**INCOME TAXES.** Our effective tax rate from continuing operations was a tax expense of 29.8% for the three months ended September 30, 2018 compared to a tax benefit of 67.8% for the three months ended September 30, 2017. Compared to the U.S. statutory rate for the three months ended September 30, 2018, the effective tax rate was increased by state taxes, foreign taxes, and nondeductible expenses. The effective tax rate was decreased by research and development tax credits and other tax credits. Compared to the U.S. statutory rate for the three months ended September 30, 2017, the effective tax rate was increased by state taxes and nondeductible expenses. The effective tax rate was decreased by lower income tax rates on income earned in foreign jurisdictions, domestic production activities deduction, valuation allowance release and research and development credits.

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	Nine Months Ended September 30,			
	2018	%	2017	%
Sales	905,191	100.0	% 741,155	100.0
Cost of sales	659,560	72.9	% 540,741	73.0
Gross profit	245,631	27.1	% 200,414	27.0
Selling, general and administrative expenses	197,609	21.8	% 175,411	23.7
Income from operations	48,022	5.3	% 25,003	3.4
Other (income) expense, net	(1,318)	(0.2)	% (324)	—
Interest expense	15,959	1.9	% 12,573	1.7
Income before taxes	33,381	3.7	% 12,754	1.7
Provision for income taxes	8,962	0.9	% 2,880	0.4
Net income	24,419	2.8	% 9,874	1.3
Net income (loss) attributable to noncontrolling interest	(91)	—	% (360)	—
Net income attributable to DXP Enterprises, Inc.	24,510	2.8	% 10,234	1.3
Per share amounts attributable to DXP Enterprises, Inc.				
Basic earnings per share	\$ 1.39		\$ 0.58	
Diluted earnings per share	\$ 1.33		\$ 0.56	

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

**SALES.** Sales for the nine months ended September 30, 2018 increased \$164.0 million, or 22.1%, to approximately \$905.2 million from \$741.2 million for the prior year's corresponding period. Sales from a business acquired on January 1, 2018 accounted for \$35.0 million of the increase in sales. Excluding the first nine months of 2018 sales of the business acquired, sales for the first nine months of 2018 sales increased by \$129.0 million, or 17.4% from the prior year's corresponding period. This sales increase is the result of an increase in our SC, IPS and SCS segments of \$47.4 million, \$74.0 million and \$7.7 million, respectively, excluding acquisition sales. The fluctuations in sales is further explained in our business segment discussions below.

**Innovative Pumping Solutions segment.** Sales for the IPS segment increased by \$74.0 million, or 51.2% for the nine months ended September 30, 2018 compared to the prior year's corresponding period. This increase was primarily the result of an increase in the capital spending by oil and gas producers and related businesses stemming from an increase in the drilling rig count production and the price of oil during the first nine months of 2018. This level of IPS sales might continue, or improve, during the remainder of 2018 if crude oil and natural gas prices and the drilling rig count remain at levels experienced during the first nine months of 2018.

**Service Centers segment.** Sales for the Service Centers segment increased by \$82.4 million, or 17.4% for the nine months ended September 30, 2018 compared to the prior year's corresponding period. Excluding \$35.0 million of Service Centers segment sales for the nine months ended September 30, 2018 from a business acquired, Service Centers segment sales for the period increased \$47.4 million, or 10.0% from the prior year's corresponding period. This sales increase is primarily the result of increased sales of rotating equipment, bearings and metal working products to customers engaged in the late upstream, midstream or downstream oil and gas markets or manufacturing equipment for these markets in connection with increased capital spending by oil and gas producers. If crude oil and natural gas prices and the drilling rig count remain at levels experienced during the third quarter of 2018, this level of sales to the oil and gas industry might continue, or improve, during the remainder of 2018.

**Supply Chain Services segment.** Sales for the SCS segment increased by \$7.7 million, or 6.3%, for the nine months ended September 30, 2018, compared to the prior year's corresponding period. The increase in sales is primarily related to increased sales to customers in the oil and gas and aerospace industries. We suspect customers in the oilfield

services and oilfield equipment manufacturing industries purchased more from DXP because of the increase in capital spending by oil and gas companies operating in the U.S.

**GROSS PROFIT.** Gross profit as a percentage of sales for the nine months ended September 30, 2018 increased by approximately 10 basis points from the prior year's corresponding period. Excluding the impact of the business acquired, gross profit as a percentage of sales increased by approximately 47 basis points. The increase in the gross profit percentage excluding the business acquired, is primarily the result of an approximate 258 basis points increase in the gross profit percentage in our IPS segment. These fluctuations are explained in the segment discussions below.

**Innovative Pumping Solutions segment.** As a percentage of sales, the nine month period gross profit percentage for the IPS segment increased approximately 258 basis points from the prior year's corresponding period primarily as a result of an increase in utilization and capacity within IPS' engineered-to-order business and an overall improvement in the pricing environment driven by an increase in capital spending by oil and gas producers. Additionally, gross profit margins for individual orders have continued to improve because of the increase in sales of built to order customer specific products. Operating income for the IPS segment increased \$17.0 million, or 239.5%, primarily as a result of the above mentioned increase in sales.

**Service Centers segment.** As a percentage of sales, the nine month period gross profit percentage for the Service Centers decreased approximately 37 basis points but increased approximately 39 basis points, adjusting for the business acquired, from the prior year's corresponding period. This was primarily as a result of sales mix and price increases from vendors. Operating income for the Service Centers segment increased \$11.0 million, or 23.3%. The increase in operating income is primarily the result of the improved sales.

**Supply Chain Services segment.** Gross profit as a percentage of sales decreased approximately 44 basis points, compared to the prior year's corresponding period. This was primarily as a result of sales mix and contractual lag effects of price increases from vendors. Operating income for the nine months ended September 30, 2018 increased 0.4 million compared to the prior year's corresponding period mainly due to an increase in gross profit of \$1.2 million primarily offset by an increase in SG&A of \$0.8 million.

**SELLING, GENERAL AND ADMINISTRATIVE ("SG&A").** Selling, general and administrative expense for the nine months ended September 30, 2018 increased by approximately \$22.2 million, or 12.7%, to \$197.6 million from \$175.4 million for the prior year's corresponding period. Selling, general and administrative expense from a business that was acquired accounted for \$2.2 million of the increase. Excluding the first nine months of 2018 expenses from the business that was acquired, SG&A for the nine months increased by \$20.0 million, or 11.4%. The overall increase in SG&A adjusting for the business acquired is the result of increased payroll, incentive compensation and related taxes and 401(k) expenses primarily due to increased headcount. The remaining increase in SG&A expense for the first nine months of 2018 is primarily a result of the increase in sales. As a percentage of sales, the nine months ended September 30, 2018 expense decreased approximately 121 basis points to 22.5% from 23.7% for the prior year's corresponding period, adjusting for the business acquired, primarily as a result of the percentage increase in sales exceeding the percentage decrease in SG&A.

**OPERATING INCOME.** Operating income for the nine months ended September 30, 2018 increased by \$23.0 million, to \$48.0 million, from \$25.0 million in the prior year's corresponding period. The operating income from the business acquired in 2018 increased the overall operating income for the nine months ended September 30, 2018 in the amount of \$4.1 million. Excluding the operating income from the business acquired, operating income increased \$18.9 million, or 75.6% from the prior year's corresponding period. This increase in operating income is primarily related to the increase in sales discussed above.

**INTEREST EXPENSE.** Interest expense for the first nine months of 2018 increased 26.9% from the prior year's corresponding period primarily as a result of increased interest rates under our new credit facilities put in place on August 29, 2017. Under our senior secured Term Loan B, DXP borrow at a spread over LIBOR. LIBOR increased 67 basis points from January through September 30, 2018.



INCOME TAXES. Our effective tax rate from continuing operations was a tax expense of 26.9% for the nine months ended September 30, 2018 compared to a tax expense of 22.6% for the nine months ended September 30, 2017. Compared to the U.S. statutory rate for the nine months ended September 30, 2018, the effective tax rate was increased by state taxes, foreign taxes, and nondeductible expenses and partially offset by research and development tax credits and other tax credits. Compared to the U.S. statutory rate for the nine months ended September 30, 2017, the effective tax rate was increased by state taxes and nondeductible expenses and partially offset by lower income tax rates on income earned in foreign jurisdictions, domestic production activities deduction, valuation allowance release, and research and development credits.

## LIQUIDITY AND CAPITAL RESOURCES

## General Overview

Our primary source of capital is cash flow from operations, supplemented as necessary by bank borrowings or other sources of debt. As a distributor of MRO products and services, we require significant amounts of working capital to fund inventories and accounts receivable. Additional cash is required for capital items for information technology, warehouse equipment, leasehold improvements, pump manufacturing equipment and safety services equipment. We also require cash to pay our lease obligations and to service our debt.

The following table summarizes our net cash flows used in and provided by operating activities, net cash used in investing activities and net cash (used in) provided by financing activities for the periods presented (in thousands):

	Nine Months Ended September 30,	
Net Cash Provided by (Used in):	2018	2017
Operating Activities	\$9,842	\$8,527
Investing Activities	(15,971 )	(2,157 )
Financing Activities	(2,994 )	14,938
Effect of Foreign Currency	(66 )	189
Net Change in Cash	\$(9,189)	\$21,497

## Operating Activities

The Company generated \$9.8 million of cash in operating activities during the nine months ended September 30, 2018 compared to generating \$8.5 million of cash during the prior year's corresponding period. The \$1.3 million increase in the amount of cash generated between the two periods was primarily driven by an increase in profitability that exceeds investments in working capital .

## Investing Activities

For the nine months ended September 30, 2018, net cash used in investing activities was \$16.0 million compared to \$2.2 million in the corresponding period in 2017. This increase was primarily driven by the purchase of ASI and investments in capital equipment. This was partially offset by proceeds from the sale of a building. For the nine months ended September 30, 2018, purchases of property, plant and equipment was approximately \$7.7 million.

## Financing Activities

For the nine months ended September 30, 2018, net cash used in financing activities was \$3.0 million, compared to net cash generated by financing activities of \$14.9 million for the corresponding period in 2017. The activity in the period was primarily attributed to the Company making principal repayments on the Term Loan.

During the nine months ended September 30, 2018, the amount available to be borrowed under our credit facility decreased to \$79.9 million September 30, 2018 compared to \$82.0 million at December 31, 2017. This was the result of \$5.1 million in letters of credit outstanding as of September 30, 2018.

We believe this is adequate funding to support working capital needs within the business.

#### Funding Commitments

We intend to pursue additional acquisition targets, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be determined with certainty. We continue to expect to fund future acquisitions primarily with cash flows from operations and borrowings, including the undrawn portion of the credit facility or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that additional financing for acquisitions will be available at terms acceptable to us.

We believe our cash generated from operations will meet our normal working capital needs during the next twelve months. However, we may require additional debt outside of our credit facilities 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.

#### ABL Facility and Senior Secured Term Loan B

##### Asset-Based Loan Facility:

On August 29, 2017, DXP entered into a five year, \$85 million Asset Based Loan and Security Agreement (the "ABL Revolver"). The ABL Revolver provides for asset-based revolving loans in an aggregate principal amount of up to \$85.0 million, subject to increase in certain circumstances (the "ABL Loans"). The interest rate for the ABL Revolver was 4.0% at September 30, 2018 with a LIBOR component of 1.8%.

The unused line fee was 0.25% at September 30, 2018. As of September 30, 2018 there were no amounts of ABL Loans outstanding under the ABL Revolver.

The Company's consolidated Fixed Charge Coverage Ratio was 3.34 to 1.00 as of September 30, 2018. DXP was in compliance with all such covenants that were in effect on such date under the ABL Revolver as of September 30, 2018.

##### Senior Secured Term Loan B:

On June 25, 2018, DXP entered into Amendment No.1 (the "Repricing Amendment") to the Term Loan Agreement for the six year Senior Secured Term Loan B (the "Term Loan B") with an original principal amount of \$250 million which amortizes in equal quarterly installments of 0.25% with the balance payable in August 2023, when the facility matures. The Company entered into the amendment for purposes of reducing the applicable margin that is applied to determine the effective interest rate from time to time in effect under the Term Loan Agreement. Under the terms of the First Amendment the applicable margin that is applied under the Term Loan Agreement with respect to LIBOR based loans was reduced from LIBOR plus 5.5% to LIBOR plus 4.75%, and the applicable margin that is applied under the Term Loan Agreement with respect to "Base Rate Loans" was reduced from 4.5% to 3.75%.

The interest rate for the Term Loan B was 7.0% as of September 30, 2018. At September 30, 2018, the aggregate principal amount of Term Loan B borrowings outstanding under the facility was \$247.5 million.

As of September 30, 2018, the Company's consolidated Secured Leverage Ratio was 2.69 to 1.00. DXP was in compliance with all such covenants that were in effect on such date under the Term Loan B facility as of September 30, 2018.

##### Borrowings (in thousands):

	September 30, 2018	December 31, 2017	Increase (Decrease)
Current maturities of long-term debt	\$ 3,394	\$ 3,381	\$ 13
Long-term debt less unamortized debt issuance costs and current maturities	237,434	238,643	(1,209 )
Total long-term debt	\$ 240,828	\$ 242,024	\$ (1,196 )
Amount available <sup>(1)</sup>	\$ 79,930	\$ 82,007	\$ (2,077 )

(1) Represents the amount available to be borrowed at the indicated date under the most restrictive covenant of the credit facility in effect at the indicated date.

Performance Metrics (in days):

	Nine Months Ended September 30,		
	2018	2017	Increase (Decrease)
Days of sales outstanding	58.3	63.2	(4.9)
Inventory turns	7.6	8.5	(0.9)

Accounts receivable days of sales outstanding were 58.3 days at September 30, 2018 compared to 63.2 days at September 30, 2017. The 4.9 days decrease was primarily due to more timely payment terms in connection with an improved economy. Inventory turns were consistent between the two periods.

#### DISCUSSION OF SIGNIFICANT ACCOUNTING AND BUSINESS POLICIES

Critical accounting and business 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.

The Company's condensed financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The accompanying Condensed Consolidated Financial Statements include the accounts of the Company, its wholly owned subsidiaries and its variable interest entity ("VIE"). The accompanying unaudited Condensed Consolidated Financial Statements have been prepared on substantially the same basis as our annual Consolidated Financial Statements and should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2017. For a more complete discussion of our significant accounting policies and business practices, refer to the consolidated annual report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2018. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of results expected for the full fiscal year.

#### RECENT ACCOUNTING PRONOUNCEMENTS

See Note 3 to the Condensed Consolidated Financial Statements for information regarding recent accounting pronouncements.

#### 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 September 30, 2018 and 2017, a 100 basis point change in LIBOR would result in approximately a \$2.5 million change in annual interest expense, respectively.

#### ITEM 4: CONTROLS AND PROCEDURES.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management has used the 2013 framework set forth in the report entitled "Internal Control – Integrated Framework" published by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission to evaluate the effectiveness of the Company's internal control over financial reporting. Management had previously concluded that the Company's internal control over financial reporting was not effective due to material weaknesses in internal control over financial reporting as further discussed below. Management's remediation plans are also discussed below.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

We had material weaknesses in our control environment and monitoring to support the financial reporting process.

The Company's control environment did not sufficiently promote effective internal control over financial reporting; specifically, the following factors relating to the control environment:

- Management did not maintain effective management review controls over the monitoring and review of certain accounts.

- Management did not effectively design, document nor monitor (review, evaluate and assess) the key internal control activities that provide the accounting information contained in the Company's consolidated financial statements. We had material weaknesses related to information technology general controls ("ITGC"). We did not maintain effective ITGC, which are required to support automated controls and information technology ("IT") functionality; therefore, automated controls and IT functionality were ineffective.

#### Remediation Plans

During the second quarter of 2018, we engaged third party consultants to assist us with our efforts to design and maintain adequate and effective internal controls over financial reporting, to implement measures designed to improve our financial closing process and enhance certain internal controls, processes and procedures, including ITGC. Specifically, the Company is undertaking the following steps to remediate the deficiencies underlying these material weaknesses:

- In connection with the remediation of the material weakness in our control activities, we are enhancing our policies relating to the design, documentation, review, monitoring and approval of management review controls and other key internal control activities that provide the accounting information contained in our consolidated financial statements.
- To enhance our information technology controls, we are implementing systems and processes in order to create an effective segregation of duties, restrict user access to applications and improve output controls.

We are committed to maintaining a strong internal control environment, and believe that these remediation efforts represent significant improvements in our control environment. The identified material weaknesses in internal control will not be considered fully remediated until the internal controls over these areas have been in operation for a sufficient period of time for our management to test and conclude that the material weakness has been fully remediated. The Company will continue its efforts to implement and test the new controls in order to make this final determination.

#### Changes in Internal Control over Financial Reporting

Except as described above, there are no changes in our internal control over financial reporting that occurred during the three months ended September 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, the Company is a party to various legal proceedings arising in the ordinary course of business. While DXP is unable to predict the outcome of these lawsuits, it believes that the ultimate resolution will not have, either individually or in the aggregate, a material adverse effect on DXP's consolidated financial position, cash flows, or results of operations.

ITEM 1A. RISK FACTORS.

No material changes have occurred from risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. MINE SAFETY DISCLOSURES.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

- 3.1 Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998).
- 3.2 Bylaws, as amended on July 27, 2011 (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q, filed with the Commission on May 10, 2018).
- \* 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

Exhibits designated by the symbol \* are filed or furnished with this Quarterly Report on Form 10-Q. All exhibits not so designated are incorporated by reference to a prior filing with the Commission as indicated.



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/ Kent Yee

Kent Yee

Senior Vice President and Chief Financial Officer

(Duly Authorized Signatory and Principal Financial Officer)

Dated: November 6, 2018