

DXP ENTERPRISES INC
Form 10-Q
November 08, 2010

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, 2010

or

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

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

Texas 76-0509661
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

7272 Pinemont, Houston, Texas 77040 (713) 996-4700
(Address of principal executive offices)(Zip Code) (Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

Number of shares of registrant's Common Stock outstanding as of November 8, 2010: 13,924,215.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

DXP ENTERPRISES, INC., AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 1,208 | \$ 2,344 |
| Trade accounts receivable, net of allowances for doubtful accounts of \$3,535 in 2010 and \$3,006 in 2009 | 98,780 | 77,066 |
| Inventories, net | 70,873 | 72,581 |
| Prepaid expenses and other current assets | 3,159 | 3,533 |
| Federal income tax recoverable | - | 235 |
| Deferred income taxes | 8,532 | 7,833 |
| Total current assets | 182,552 | 163,592 |
| Property and equipment, net | 15,501 | 16,955 |
| Goodwill | 79,488 | 60,542 |
| Other intangibles, net of accumulated amortization of \$18,118 in 2010 and \$13,779 in 2009 | 28,380 | 25,727 |
| Non-current deferred income taxes | 2,813 | 3,289 |
| Other assets | 877 | 822 |
| Total assets | \$ 309,611 | \$ 270,927 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 10,924 | \$ 12,595 |
| Trade accounts payable | 54,361 | 51,185 |
| Accrued wages and benefits | 10,880 | 6,633 |
| Federal income taxes payable | 6,221 | - |
| Customer advances | 10,186 | 1,008 |
| Other accrued liabilities | 3,398 | 6,377 |
| Total current liabilities | 95,970 | 77,798 |
| Long-term debt, less current portion | 98,492 | 102,916 |
| Shareholders' equity: | | |
| Series A preferred stock, 1/10th vote per share; \$1.00 par value; liquidation preference of \$100 per share (\$112 at September 30, 2010); 1,000,000 shares authorized; 1,122 shares issued and outstanding | 1 | 1 |

| | | |
|---|---------|------------|
| Series B convertible preferred stock, 1/10th vote per share; \$1.00 par value; \$100 stated value; liquidation preference of \$100 per share (\$1,500 at September 30, 2010); 1,000,000 shares authorized; 15,000 shares issued and outstanding | 15 | 15 |
| Common stock, \$0.01 par value, 100,000,000 shares authorized; 13,893,956 in 2010 and 12,935,201 in 2009 shares issued and outstanding | 139 | 129 |
| Paid-in capital | 69,484 | 58,037 |
| Retained earnings | 45,510 | 32,057 |
| Accumulated other comprehensive income (loss) | - | (26) |
| Total shareholders' equity | 115,149 | 90,213 |
| Total liabilities and shareholders' equity | 306,611 | \$ 270,927 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| Sales | \$ 172,249 | \$ 143,422 | \$ 486,533 | \$ 445,400 |
| Cost of sales | 123,360 | 102,644 | 347,786 | 317,164 |
| Gross profit | 48,889 | 40,778 | 138,747 | 128,236 |
| Selling, general and administrative expense | 38,731 | 35,145 | 112,713 | 110,790 |
| Operating income | 10,158 | 5,633 | 26,034 | 17,446 |
| Other income | 29 | 9 | 243 | 71 |
| Interest expense | (1,425) | (1,232) | (4,023) | (4,020) |
| Income before income taxes | 8,762 | 4,410 | 22,254 | 13,497 |
| Provision for income taxes | 3,417 | 1,726 | 8,733 | 5,475 |
| Net income | 5,345 | 2,684 | 13,521 | 8,022 |
| Preferred stock dividend | (23) | (22) | (68) | (60) |
| Net income attributable to common shareholders | \$ 5,322 | \$ 2,662 | \$ 13,453 | \$ 7,962 |
| Basic income per share | \$ 0.38 | \$ 0.20 | \$ 0.98 | \$ 0.61 |
| Weighted average common s h a r e s outstanding | 14,023 | 13,132 | 13,710 | 13,105 |
| Diluted income per share | \$ 0.36 | \$ 0.19 | \$ 0.93 | \$ 0.57 |
| Weighted average common and common equivalent shares outstanding | 15,056 | 14,004 | 14,764 | 13,978 |

See notes to condensed consolidated financial statements.

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

| | NINE MONTHS ENDED SEPTEMBER 30 | |
|---|-----------------------------------|----------|
| | 2010 | 2009 |
| OPERATING ACTIVITIES: | | |
| Net income | \$ 13,521 | \$ 8,022 |
| Adjustments to reconcile net income to net cash provided by operating activities – net of acquisitions and divestitures | | |
| Depreciation | 2,782 | 3,354 |
| Amortization of intangibles | 4,339 | 5,420 |
| Compensation expense for restricted stock | 716 | 1,243 |
| Tax benefit related to exercise of stock options and vesting of restricted stock | (408) | (6) |
| Deferred income taxes | (223) | (1,233) |
| Gain on sale of property and equipment | (188) | - |
| Changes in operating assets and liabilities, net of assets and liabilities acquired in business combinations: | | |
| Trade accounts receivable | (16,124) | 22,855 |
| Inventories | 6,496 | 28,009 |
| Prepaid expenses and other current assets | 891 | (2,251) |
| Accounts payable and accrued expenses | 6,852 | (27,264) |
| Net cash provided by operating activities | 18,654 | 38,149 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (901) | (1,482) |
| Purchase of businesses, net of cash acquired | (10,965) | 16 |
| Proceeds from the sale of business | 1,428 | (491) |
| Net cash used in investing activities | (10,438) | (1,957) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from debt | 96,723 | 97,387 |

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| | | |
|--|-----------|-----------|
| Principal payments on revolving line of credit and other long-term debt | (106,540) | (137,070) |
| Dividends paid in cash | (68) | (60) |
| Proceeds from exercise of stock options | 125 | 10 |
| Tax benefit related to exercise of stock options and vesting of restricted stock | 408 | 6 |
| Net cash used in financing activities | (9,352) | (39,727) |
| DECREASE IN CASH | (1,136) | (3,535) |
| CASH AT BEGINNING OF PERIOD | 2,344 | 5,698 |
| CASH AT END OF PERIOD | \$ 1,208 | \$ 2,163 |

Purchase of businesses excludes \$14 million of common stock and convertible notes issued in connection with an acquisition during 2010. Proceeds from debt exclude \$6.3 million of convertible notes issued in connection with an acquisition in 2010 and converted to common stock in 2010.

See notes to condensed consolidated financial statements.

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

| | Three Months Ended September 30, 2010 | | Nine Months Ended September 30, 2010 | |
|---|--|----------|---|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 5,345 | \$ 2,684 | \$ 13,521 | \$ 8,022 |
| Gain from interest rate swap, | - | 181 | 26 | 441 |
| net of income taxes | | | | |
| Comprehensive income | \$ 5,345 | \$ 2,865 | \$ 13,547 | \$ 8,463 |
| See notes to consolidated condensed financial statements. | | | | |

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

NOTE 1: BASIS OF PRESENTATION

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

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission (the “SEC”).

NOTE 2: THE COMPANY

DXP Enterprises, Inc., a Texas corporation, was incorporated on July 26, 1996, to be the successor to SEPCO Industries, Inc. DXP is engaged in the business of distributing maintenance, repair and operating products, equipment and service to industrial customers. DXP management has modified how it manages and evaluates the segments of our business. The Company is now organized into three segments: Maintenance, Repair and Operating (“MRO”), Supply Chain Services (“SCS”) and Innovative Pumping Solutions (“IPS”). See Note 8 for discussion of the segments.

NOTE 3: RECENT ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (“FASB”) issued authoritative guidance that requires new disclosures of (i) the amounts of significant transfers into and out of Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers and (ii) information in the reconciliation of recurring Level 3 measurements (those using significant unobservable inputs) about purchases, sales, issuances, and settlements on a gross basis. This update also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to disclose information about purchases, sales, issuances and settlements in the reconciliation of Level 3 measurements, which does not become effective until interim and annual periods beginning after December 15, 2010. As this guidance clarifies and provides for additional disclosure requirements only, the adoption of this guidance did not have an impact on the Company’s results of operations, financial position or cash flows.

NOTE 4: STOCK-BASED COMPENSATION

Stock Options as of the Quarterly Period Ended September 30, 2010

No future grants will be made under the Company’s stock option plans. No grants of stock options have been made by the Company since July 1, 2005. As of September 30, 2010, no stock options were outstanding.

The following table summarizes stock options outstanding and changes during the nine months ended September 30, 2010:

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| Options Outstanding and Exercisable | | | | |
|---|------------------------|--|---|---------------------------------|
| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
| O p t i o n s outstanding at December 31, 2009 | 50,000 | \$ 2.50 | 3.2 | \$ 529,000 |
| Granted | - | | | |
| Exercised | 50,000 | \$ 2.50 | | |
| Options outstanding and exercisable at September 30, 2010 | - | - | - | - |

The total intrinsic value, or the difference between the exercise price and the market price on the date of exercise, of all options exercised during the nine months ended September 30, 2010 was \$489,000. Cash received from stock options exercised during the nine months ended September 30, 2010 was \$125,000.

Restricted Stock.

Under the restricted stock plan approved by our shareholders in July 2005 (the “Restricted Stock Plan”), directors, consultants and employees may be awarded shares of DXP’s common stock. The shares of restricted stock granted to employees as of September 30, 2010 vest 100% one year after the grant date, 33.3% each year for three years after the grant date, 20% each year for five years after the grant date or 10% each year for ten years after the grant date, as specified in the award of such grant. The Restricted Stock Plan provides that on each July 1 during the term of the plan each non-employee director of DXP will be granted the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on such date. The shares of restricted stock granted to non-employee directors of DXP vest 100% one year after the grant date. The fair value of restricted stock awards is measured based upon the closing prices of DXP’s common stock on the grant dates and is recognized as compensation expense over the vesting period of the awards.

The following table provides certain information regarding the shares authorized and outstanding under the Restricted Stock Plan at September 30, 2010:

| | |
|--|---------|
| Number of shares authorized for grants | 600,000 |
| Number of shares granted | 474,662 |
| Number of shares forfeited | 59,649 |
| | 184,987 |

Number of shares
available for
future grants
Weighted-average \$15.24
grant price of
granted shares

Changes in restricted stock for the nine months ended September 30, 2010 were as follows:

| | Number of Shares | Weighted Average Grant Price |
|--------------------------------|------------------------|---------------------------------------|
| Unvested at December 31, 2009 | 223,448 | \$ 15.29 |
| Granted | 73,781 | \$ 15.10 |
| Forfeited | (36,885) | \$ 17.07 |
| Vested | (69,627) | \$ 13.01 |
| Unvested at September 30, 2010 | 190,717 | \$ 15.55 |

Compensation expense associated with restricted stock recognized in the nine months ended September 30, 2010 and 2009 was \$716,000 and \$1,243,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$2,301,000 and \$2,601,000 at September 30, 2010 and December 31, 2009, respectively. As of September 30, 2010, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 28 months.

NOTE 5: INVENTORY

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

| | September 30, 2010 | December 31, 2009 |
|-----------------|--------------------------|-------------------------|
| Finished goods | \$ 68,542 | \$ 72,270 |
| Work in process | 2,331 | 311 |
| Inventories | \$ 70,873 | \$ 72,581 |

NOTE 6: GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill and other intangibles during the nine months ended September 30, 2010 are as follows as of the dates specified (in thousands):

| | Total | Goodwill | Other Intangibles |
|----------------------------------|------------|-----------|----------------------|
| Balance as of December 31, 2009 | \$ 86,269 | \$ 60,542 | \$ 25,727 |
| Acquired during the period | 25,838 | 18,846 | 6,992 |
| Payment of earn out | 100 | 100 | - |
| Amortization | (4,339) | - | (4,339) |
| Balance as of September 30, 2010 | \$ 107,868 | \$ 79,488 | \$ 28,380 |

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

| | As of September 30, 2010 | | As of December 31, 2009 | |
|------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Vendor agreements | \$ 2,496 | \$ (800) | \$ 2,496 | \$ (706) |
| Customer relationships | 42,240 | (15,811) | 35,390 | (11,908) |
| Non-compete agreements | 1,762 | (1,507) | 1,620 | (1,165) |
| Total | \$ 46,498 | \$ (18,118) | \$ 39,506 | \$ (13,779) |

Other intangible assets are generally amortized on a straight line basis over the useful lives of the assets. The adjustment to goodwill relates to the payment of contingent purchase price for Falcon Pump.

NOTE 7. EARNINGS PER SHARE DATA

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

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|---|------------------------------------|--------------|-----------------------------------|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| Basic: | | | | |
| Weighted average shares outstanding | 14,022,657 | 13,131,547 | 13,709,961 | 13,104,622 |
| Net income | \$ 5,345,000 | \$ 2,684,000 | \$13,521,000 | \$ 8,022,000 |
| Convertible preferred stock dividend | (23,000) | (22,000) | (68,000) | (60,000) |
| Net income attributable to common shareholders | \$ 5,322,000 | \$ 2,662,000 | \$ 13,453,000 | \$ 7,962,000 |
| Per share amount | \$ 0.38 | \$ 0.20 | \$ 0.98 | \$ 0.61 |
| Diluted: | | | | |
| Weighted average shares outstanding | 14,022,657 | 13,131,547 | 13,709,961 | 13,104,622 |
| Net effect of dilutive stock options – based on the treasury stock method | - | 32,784 | 9,625 | 33,522 |
| Assumed conversion of convertible notes | 193,420 | | 204,341 | - |
| Assumed conversion of convertible preferred stock | 840,000 | 840,000 | 840,000 | 840,000 |
| Total | 15,056,077 | 14,004,331 | 14,763,927 | 13,978,144 |
| Net income | \$ 5,345,000 | \$ 2,662,000 | \$ 13,521,000 | \$ 7,962,000 |
| Interest on convertible notes, after income taxes | 47,000 | | 142,000 | |
| Convertible preferred stock dividend | 23,000 | 22,000 | 68,000 | 60,000 |
| Net income for diluted earnings per share | \$ 5,415,000 | \$ 2,684,000 | \$ 13,731,000 | \$ 8,022,000 |
| Per share amount | \$ 0.36 | \$ 0.19 | \$ 0.93 | \$ 0.57 |

NOTE 8: SEGMENT REPORTING

The MRO Segment is engaged in providing maintenance, repair and operating products, equipment and integrated services, including logistics capabilities, to industrial customers. The MRO segment provides a wide range of MRO products in the fluid handling equipment, bearing, power transmission equipment, fastener, general mill, safety supply and electrical products categories. The Innovative Pumping Solutions segment fabricates and assembles custom-made engineered pump packages. The Supply Chain Services segment manages all or part of customer supply chains,

including inventories. The 2009 segment information has been restated to conform with the 2010 composition of reportable segments.

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

Financial information relating the Company's segments is as follows for the periods indicated:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|--|----------------------------------|------------------------------|-----------------------|------------|---------------------------------|------------------------------|-----------------------|------------|
| | MRO | Innovative Pumping Solutions | Supply Chain Services | Total | MRO | Innovative Pumping Solutions | Supply Chain Services | Total |
| 2010 | | | | | | | | |
| Sales | \$ 117,739 | \$ 22,574 | \$ 31,936 | \$ 172,249 | \$ 338,124 | \$ 53,596 | \$ 94,813 | \$ 486,533 |
| Operating income for reportable segments | 13,538 | 2,368 | 1,828 | 17,734 | 37,078 | 7,147 | 5,370 | 49,595 |
| 2009 | | | | | | | | |
| Sales | \$ 95,606 | \$ 14,125 | \$ 33,691 | \$ 143,422 | \$ 298,467 | \$ 43,975 | \$ 102,958 | \$ 445,400 |
| Operating income for reportable segments | 8,786 | 2,022 | 1,657 | 12,465 | 32,794 | 6,267 | 5,347 | 44,408 |

A reconciliation of operating income for reportable segments to the consolidated income before taxes is as follows for the periods indicated (in thousands):

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|--|---------------------------------|-----------|--------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Operating income for reportable segments | \$ 17,734 | \$ 12,465 | \$ 49,595 | \$ 44,408 |
| Adjustment for: | | | | |
| Amortization of intangibles | 1,520 | 1,807 | 4,339 | 5,420 |
| Corporate and other expense, net | 6,056 | 5,025 | 19,222 | 21,542 |
| Total operating income | 10,158 | 5,633 | 26,034 | 17,446 |
| Interest expense, net | 1,425 | 1,232 | 4,023 | 4,020 |
| Other expense (income), net | (29) | (9) | (243) | (71) |
| Income before income taxes | \$ 8,762 | \$ 4,410 | \$ 22,254 | \$ 13,497 |

NOTE 9. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Effective January 1, 2008, DXP adopted authoritative guidance for financial assets and liabilities measured on a recurring basis. This authoritative guidance applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. Fair value, as defined in the authoritative guidance, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance affects the fair value measurement of an interest rate swap to which the Company was a party until January 11, 2010, which must be classified in one of the following categories:

Level 1 Inputs

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

Level 2 Inputs

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

Level 3 Inputs

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

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

The following presents the changes in Level 3 liabilities for the three months and nine months ended September 30, 2010 and 2009 (in thousands):

| | Interest Rate Swap | |
|---|--------------------|------------|
| | 2010 | 2009 |
| Three Months Ended September 30 | | |
| Fair value at July 1 | \$ - | \$ (768) |
| Realized and unrealized gains (losses) included in other comprehensive income | - | 302 |
| Fair value at September 30 | \$ - | \$ (466) |
| Nine months Ended September 30 | | |
| Fair value at January 1 | \$ (42) | \$ (1,202) |
| Realized and unrealized gains (losses) Included in other comprehensive income | 42 | 736 |
| Fair value at September 30 | \$ - | \$ (466) |

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

NOTE 10: OTHER COMPREHENSIVE INCOME

Other comprehensive income generally represents all changes in shareholders' equity during the period, except those resulting from investments by, or distributions to, shareholders. The Company has other comprehensive income related to changes in interest rates in connection with an interest rate swap, which was recorded as follows for the periods indicated (in thousands):

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|--|---------------------------------------|---------|-----------------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 5,345 | \$2,684 | \$ 13,521 | \$8,022 |
| Gain from interest rate swap, net of income taxes | - | 181 | 26 | 441 |
| Other comprehensive income | \$ 5,345 | \$2,865 | \$ 13,547 | \$8,463 |

At December 31, 2009 and September 30, 2010, the accumulated derivative loss, net of income taxes, was \$26,000 and zero, respectively.

NOTE 11: ACQUISITION

On April 1, 2010, DXP acquired substantially all the assets of Quadna, Inc. ("Quadna"). The purchase price of approximately \$25.0 million (net of \$3.0 million of acquired cash) consisted of \$11 million paid in cash, \$10 million in the form of convertible promissory notes bearing interest at a rate of 10% and approximately \$4.0 million in the form of 343,337 shares of DXP common stock.

On April 9, 2010, \$4.5 million principal amount of the convertible promissory notes, along with accrued interest, were converted into 376,417 shares of DXP's common stock. On August 18, 2010, \$3.7 million of the convertible promissory notes were paid off using funds obtained from DXP's credit facility and \$1.8 million of the convertible promissory notes were converted to 117,374 shares of DXP common stock. The \$11 million cash portion of the purchase price was funded by borrowings under DXP's existing credit facility. Quadna is headquartered in Arizona and operates out of eight locations in Arizona, Colorado, Wyoming, Montana, Mexico, Nevada and Utah. Quadna distributes and services fluid and air handling pumps and fabricates pump packages. DXP completed this acquisition to expand its pump business in the Western U.S. DXP incurred approximately \$0.7 million of acquisition-related costs, which were recognized as selling, general and administrative expenses in the periods incurred. The acquisition of Quadna has been accounted for using the purchase method of accounting. Revenues and expenses of the acquired business have been included in the accompanying consolidated financial statements beginning on the date of acquisition. The allocation of purchase price to the acquired assets and liabilities is based on estimates of fair market value. All of the goodwill and other intangibles associated with this acquisition are expected to be deductible for tax purposes.

The pro forma unaudited results of operations for the Company on a consolidated basis for the three months and nine months ended September 30, 2010 and 2009, assuming the purchase was consummated as of January 1, of each year follows (in thousands, except per share data):

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|------------------|------------------------------------|-----------|-----------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net sales | \$172,249 | \$155,275 | \$499,346 | \$480,959 |
| Net income | 5,345 | 3,002 | 13,911 | 8,901 |
| Per share data | | | | |
| Basic earnings | \$0.38 | \$0.22 | \$1.00 | \$0.66 |
| Diluted earnings | \$0.36 | \$0.21 | \$0.94 | \$0.62 |

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed in connection with the acquisition described above (in thousands):

| | |
|--------------------------|---------|
| Cash | \$3,035 |
| Accounts Receivable | 5,824 |
| Inventory | 5,774 |
| Property and equipment | 737 |
| Goodwill and intangibles | 25,838 |

| | |
|-----------------------------------|----------|
| Other assets | |
| Assets acquired | 41,397 |
| Current liabilities assumed | (13,397) |
| Net assets acquired | \$28,000 |

NOTE 12: SUBSEQUENT EVENTS

In May 2009, the FASB issued authoritative guidance, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The authoritative guidance provides guidance on the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity

should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company evaluated subsequent events through the date this report was filed with the SEC.

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

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this "Report") contains statements that constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Such statements can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "estimates", "will", "should", "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and actual results may vary materially from those discussed in the forward-looking statements as a result of various factors. These factors include the effectiveness of management's strategies and decisions, our ability to affect our internal growth strategy, general economic and business conditions, developments in technology, our ability to effectively integrate businesses we may acquire, new or modified statutory or regulatory requirements and changing prices and market conditions. This Report identifies other factors that could cause such differences. We cannot assure you that these are all of the factors that could cause actual results to vary materially from the forward-looking statements. We assume no obligation and do not intend to update these forward-looking statements.. Unless the context otherwise requires, references in this Report to the "Company", "DXP", "We" or "Our" shall mean DXP Enterprises, Inc., a Texas corporation, together with its subsidiaries.

Impact of Current Economic Conditions

As with most businesses, our results of operations have been adversely impacted by current economic conditions. If economic conditions do not improve, we expect our results of operations will continue to be adversely impacted. We will continue to look for opportunities to reduce our expenses and debt.

RESULTS OF OPERATIONS

| | Three Months Ended September 30, | | | | Nine months Ended September 30, | | | |
|---|----------------------------------|-------|-----------|-------|---------------------------------|-------|-----------|-------|
| | 2010 | % | 2009 | % | 2010 | % | 2009 | % |
| Sales | \$172,249 | 100.0 | \$143,422 | 100.0 | \$486,533 | 100.0 | \$445,400 | 100.0 |
| Cost of sales | 123,360 | 71.6 | 102,644 | 71.6 | 347,786 | 71.5 | 317,164 | 71.2 |
| Gross profit | 48,889 | 28.4 | 40,778 | 28.4 | 138,747 | 28.5 | 128,236 | 28.8 |
| Selling, general and administrative expense | 38,731 | 22.5 | 35,145 | 24.5 | 112,713 | 23.2 | 110,790 | 24.9 |
| Operating income | 10,158 | 5.9 | 5,633 | 3.9 | 26,034 | 5.3 | 17,446 | 3.9 |
| Interest expense | (1,425) | (0.8) | (1,232) | (0.8) | (4,023) | (0.8) | (4,020) | (0.9) |
| Other income | 29 | - | 9 | - | 243 | 0.1 | 71 | - |
| Income before income taxes | 8,762 | 5.1 | 4,410 | 3.1 | 22,254 | 4.6 | 13,497 | 3.0 |
| Provision for income taxes | 3,417 | 2.0 | 1,726 | 1.2 | 8,733 | 1.8 | 5,475 | 1.2 |
| Net income | \$5,345 | 3.1 | \$ 2,684 | 1.9 | \$ 13,521 | 2.8 | \$ 8,022 | 1.8 |

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| Per share amounts | | | | |
|----------------------------|--------|--------|--------|--------|
| Basic earnings per share | | \$0.20 | | \$0.61 |
| | \$0.38 | | \$0.98 | |
| Diluted earnings per share | | \$0.19 | | \$0.57 |
| | \$0.36 | | \$0.93 | |

DXP management has modified how it manages and evaluates the segments of our business. DXP is now organized into three segments: Maintenance, Repair and Operating (“MRO”), Supply Chain Services (“SCS”) and Innovative

Pumping Solutions (“IPS”). The MRO Segment is engaged in providing maintenance, repair and operating products, equipment and integrated services, including logistics capabilities, to industrial customers. The MRO segment provides a wide range of MRO products in the fluid handling equipment, bearing, power transmission equipment, fastener, general mill, safety supply and electrical products categories. The IPS segment fabricates and assembles custom-made engineered pump packages. The SCS segment manages all or part of customer supply chains, including inventories. The 2009 segment information has been restated to conform with the 2010 composition of reportable segments.

Three months ended September 30, 2010 compared to Three Months Ended September 30, 2009

SALES. Sales for the quarter ended September 30, 2010 increased \$28.8 million, or 20.1%, to approximately \$172.2 million from \$143.4 million for the same period in 2009. Sales by Quadna, acquired April 1, 2010, accounted for \$14.5 million of third quarter 2010 sales. Excluding Quadna sales, sales for the three months ended September 30, 2010 increased 10.0%. Sales for the MRO segment increased \$22.1 million, or 23.2%. Excluding Quadna MRO sales of \$7.7 million, MRO sales for the third quarter of 2010 increased 15.1% from the third quarter of 2009. This sales increase is primarily due to improvement in the industrial portion of the U.S. economy. Sales for the SCS segment decreased by \$1.8 million, or 5.2%, for the current three months when compared to the same period in 2009. The sales decrease resulted from sales to customers in 2009 which subsequently terminated supply agreements, exceeding sales to customers which had been added since the third quarter of 2009. Sales for the IPS segment increased by \$8.4 million, or 59.8%, for the current three months when compared to the same period in 2009. Excluding Quadna IPS sales of \$6.8 million for the third quarter of 2010, IPS sales increased 11.5% from the third quarter of 2009. The sales increase resulted from the improvement in the economy and the associated increase in capital spending by our customers.

GROSS PROFIT. Gross profit as a percentage of sales was 28.4% for the third quarter of 2010 and 2009.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE. Selling, general and administrative expense for the three months ended September 30, 2010 increased by approximately \$3.6 million, or 10.2%, when compared to the same period in 2009. Selling, general and administrative expense for Quadna for the three months ended September 30, 2010 was \$2.7 million. As a percentage of revenue, the 2010 expense decreased to 22.5%, from 24.5% for the three months ended September 30, 2009. This decrease is primarily the result of sales increasing 20.1% and expenses increasing only 10.2%.

OPERATING INCOME. Operating income for the three months ended September 30, 2010 increased 80.3% compared to the same period in 2009. Operating income for the MRO segment increased 54.1% as a result of the 23.2% increase in sales combined with the effect of cost reduction measures implemented during 2009. Operating income for the SCS segment increased 10.3%, primarily as a result of the reduced costs for this segment. Operating income for the IPS segment increased 17.1% as a result of the 59.8% increase in sales.

INTEREST EXPENSE. Interest expense for the three months ended September 30, 2010 increased by 15.7% from the same period in 2009. This increase primarily resulted from increased interest rates. On March 15, 2010 we amended our credit facility. This amendment significantly increased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before March 15, 2010. The amendment increased the cost of funds borrowed under our credit facility by approximately 200 basis points beginning on March 16, 2010.

Nine months Ended September 30, 2010 compared to Nine months Ended September 30, 2009

SALES. Sales for the nine months ended September 30, 2010 increased \$41.1 million, or 9.2%, to approximately \$486.5 million from \$445.4 million for the same period in 2009. Sales by Quadna, acquired April 1, 2010, accounted

for \$27.9 million of 2010 sales. Excluding Quadna sales, sales for the nine months ended September 30, 2010 increased 3.0%. Sales for the MRO segment increased \$39.7 million, or 13.3%. Excluding Quadna MRO sales of \$14.8 million, MRO sales for the nine months ended September 30, 2010 increased 8.3% from the same period for 2009. This sales increase is primarily due to improvement in the industrial portion of the U.S. economy. Sales for the SCS segment decreased by \$8.1 million, or 7.9%, for the current nine months when compared to the same period in 2009. The sales decrease resulted from sales to customers in 2009 which subsequently terminated supply agreements, exceeding sales to customers which had been added since the third quarter of 2009.

Sales for the IPS segment increased by \$9.6 million, or 21.9%, for the current nine months when compared to the same period in 2009. Excluding Quadna IPS sales of \$13.1 million, IPS sales for the first nine months of 2010 decreased 8.0% from the first nine months of 2009. The sales decrease resulted from the decline in capital spending by our customers.

GROSS PROFIT. Gross profit as a percentage of sales decreased to approximately 28.5% for the first nine months of 2010 from 28.8% for the same period in 2009. This decrease is primarily the result of competitive pressures of the U. S. economy, combined with the effect of the acquisition of Quadna which has a slightly lower gross profit percentage than the rest of DXP.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE. Selling, general and administrative expense for the nine months ended September 30, 2010 increased by approximately \$1.9 million, or 1.7%, when compared to the same period in 2009. Selling, general and administrative expense for Quadna for the six months ended September 30, 2010 was approximately \$5.3 million, including \$0.7 million of acquisition expenses. As a percentage of revenue, the 2010 expense decreased to 23.2%, from 24.9% for the nine months ended September 30, 2009. This decrease primarily resulted from sales increasing by 9.2% and expenses increasing only 1.7%.

OPERATING INCOME. Operating income for the first nine months of 2010 increased 49.2% compared to the same period in 2009. Operating income for the MRO segment increased 13.1% as a result of the 13.3% increase in sales. Operating income for the SCS segment decreased 0.4%, primarily as a result of the 7.9% decline in sales for this segment. Operating income for the IPS segment increased 14.0% as a result of the 21.9% increase in sales for this segment.

INTEREST EXPENSE. Interest expense for the nine months ended September 30, 2010 was almost equal to the expense for 2009.

ACQUISITIONS. On April 1, 2010, DXP acquired substantially all the assets of Quadna, Inc. ("Quadna"). The purchase price of approximately \$25.0 million (net of \$3.0 million of acquired cash) consisted of \$11 million paid in cash, \$10 million in the form of convertible promissory notes bearing interest at a rate of 10% and approximately \$4.0 million in the form of 343,337 shares of DXP common stock.

On April 9, 2010, \$4.5 million principal amount of the convertible promissory notes, along with accrued interest, were converted into 376,417 shares of DXP's common stock. On August 18, 2010, \$3.7 million of the convertible promissory notes were paid off using funds obtained from DXP's credit facility and \$1.8 million of the convertible promissory notes were converted to 117,374 shares of DXP common stock. The \$11 million cash portion of the purchase price was funded by borrowings under DXP's existing credit facility. Quadna is headquartered in Arizona and operates out of eight locations in Arizona, Colorado, Wyoming, Montana, Mexico, Nevada and Utah. Quadna distributes and services fluid and air handling pumps and fabricates pump packages. DXP completed this acquisition to expand its pump business in the Western U.S. DXP incurred approximately \$0.7 million of acquisition-related costs, which were recognized as selling, general and administrative expenses in the periods incurred. The acquisition of Quadna has been accounted for using the purchase method of accounting. Revenues and expenses of the acquired business have been included in the accompanying consolidated financial statements beginning on the date of acquisition. The allocation of purchase price to the acquired assets and liabilities is based on estimates of fair market value. All of the goodwill and other intangibles associated with this acquisition are expected to be deductible for tax purposes.

The pro forma unaudited results of operations for the Company on a consolidated basis for the three months and nine months ended September 30, 2010 and 2009, assuming the purchase was consummated as of January 1, of each year follows (in thousands, except per share data):

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|------------------|------------------------------------|------------|-----------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net sales | \$ 172,249 | \$ 155,275 | \$ 499,346 | \$ 480,959 |
| Net income | 5,345 | 3,002 | 13,911 | 8,901 |
| Per share data | | | | |
| Basic earnings | \$0.38 | \$0.22 | \$1.00 | \$0.66 |
| Diluted earnings | \$0.36 | \$0.21 | \$0.94 | \$0.62 |

LIQUIDITY AND CAPITAL RESOURCES

General Overview

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

We generated \$18.7 million of cash in operating activities during the first nine months of 2010 as compared to \$38.1 million during the first nine months of 2009. This change between the two periods was primarily attributable to an \$16.1 million increase in accounts receivable in the 2010 period compared to a \$22.9 million decrease in accounts receivable in the 2009 period.

During the first nine months of 2010, the amount available to be borrowed under our credit agreement with Wells Fargo Bank, National Association, as lead arranger and administrative agent for the lenders (the “Facility”) increased from \$37.3 million at December 31, 2009 to \$51.5 million at September 30, 2010. This increase in availability primarily resulted from the \$21.7 million increase in trade receivables partially offset by the \$3.7 million increase in the amount outstanding under the line of credit portion of the Facility.

On August 28, 2008, DXP entered into the Facility. The Facility was amended on March 15, 2010. The March 15, 2010 amendment to the Facility significantly increased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before March 15, 2010. The Facility consists of a \$50 million term loan and a revolving credit facility that provides a \$150 million line of credit to the Company. The term loan requires principal payments of \$2.5 million per quarter beginning on December 31, 2008. The Facility matures on August 11, 2013. The Facility contains financial covenants defining various financial measures and levels of these measures with which the Company must comply. Covenant compliance is assessed as of each quarter end and certain month ends for the asset test. The asset test is defined under the Facility as the sum of 85% of the Company’s net accounts receivable, 60% of net inventory and 50% of the net book value of non-real-estate property and equipment. The Company’s borrowing and letter of credit capacity under the revolving credit portion of the Facility at any given time is \$150 million less borrowing under the revolving credit portion of the Facility and letters of credit outstanding, subject to the asset test described above.

On September 30, 2010, the LIBOR-based rate on the revolving credit portion of the Facility was LIBOR plus 2.75%, the prime-based rate on the revolving credit portion of the Facility was the prime rate plus 1.75%, the commitment fee was 0.375%, the LIBOR-based rate for the term loan was LIBOR plus 3.25% and the prime-based rate for the term loan was the prime rate plus 2.25%. At September 30, 2010, \$106.7 million was borrowed under the Facility at a weighted average interest rate of approximately 3.9% under the LIBOR options. The revolving credit portion of the Facility provides the option of interest at LIBOR plus a margin ranging from 2.25% to 4.00% or at the prime rate plus

a margin of 1.25% to 3.00%. Commitment fees of 0.25% to 0.625% per annum are payable on the portion of the Facility capacity not in use for borrowings or letters of credit at any given time. The term loan portion of the Facility provides the option of interest at LIBOR plus a margin ranging from 2.75% to 4.50% or at the prime rate plus a margin of 1.75% to 3.50%. Borrowings under the Facility are secured by all of the Company's accounts receivable, inventory, general intangibles and non-real-estate property and equipment. At September 30, 2010, we had \$51.5 million available for borrowing and letters of credit under the Facility.

The Facility's principal financial covenants include:

Fixed Charge Coverage Ratio –The Facility requires that the Fixed Charge Coverage Ratio for the 12-month period ending on the last day of each quarter through September 30, 2010 be not less than 1.0 to 1.0, stepping up to 1.25 to 1.0 for the quarter ending December 31, 2010 and to 1.50 to 1.0 for each quarter ending on or after March 31, 2011, with “Fixed Charge Coverage Ratio” defined as the ratio of (a) EBITDA (as defined below) for the 12 months ending on such date, minus cash taxes and minus capital expenditures for such period (excluding acquisitions) to (b) the aggregate of interest expense paid in cash, scheduled principal payments in respect of long-term debt and current portion of capital leases for such 12-month period, determined in each case on a consolidated basis for DXP and its subsidiaries.

Leverage Ratio – The Facility requires that the Company's Leverage Ratio, determined at the end of each fiscal quarter, not exceed 3.75 to 1.0 as of September 30, 2010, 3.25 to 1.00 as of December 31, 2010, 3.00 to 1.00 as of March 31, 2011 and 2.75 to 1.0 as of the last day of each fiscal quarter thereafter. The Leverage Ratio is defined as the outstanding Indebtedness divided by EBITDA for the 12 months then ended. Indebtedness is defined under the Facility for financial covenant purposes as: (a) all obligations of DXP for borrowed money including but not limited to senior bank debt, senior notes and subordinated debt; (b) capital leases; (c) issued and outstanding letters of credit; and (d) contingent obligations for funded indebtedness.

EBITDA as defined under the Facility for financial covenant purposes means, without duplication, for any period the consolidated net income (excluding any extraordinary gains or losses) of DXP plus, to the extent deducted in calculating consolidated net income, depreciation, amortization, other non-cash items and non-recurring items (including, without limitation, impairment charges, asset write-offs and accruals in respect of closed locations), interest expense and tax expense for taxes based on income and minus, to the extent added in calculating consolidated net income, any non-cash items and non-recurring items; provided that, if DXP acquires the equity interests or assets of any person during such period under circumstances permitted under the Facility, EBITDA shall be adjusted to give pro forma effect to such acquisition assuming that such transaction had occurred on the first day of such period and provided further that, if DXP divests the equity interests or assets of any person during such period under circumstances permitted under the Facility, EBITDA shall be adjusted to give pro forma effect to such divestiture assuming that such transaction had occurred on the first day of such period. Add-backs allowed pursuant to Article 11, Regulation S-X, of the Securities Act of 1933, as amended, will also be included in the calculation of EBITDA.

Borrowings

| | September 30, 2010 | December 31, 2009 | Increase (Decrease) |
|--------------------------------------|--------------------------|-------------------------|------------------------|
| (in Thousands) | | | |
| Current portion of long-term debt | \$ 10,924 | \$ 12,595 | \$ (1,671) |
| Long-term debt, less current portion | 98,492 | 102,916 | (4,424) |
| Total long-term debt | \$ 109,416 | \$ 115,511 | \$ (6,095)(2) |
| Amount available | \$ 51,461(1) | \$ 37,276(1) | \$ 14,185(3) |

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

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

(3) The \$14.2 million increase in the amount available is primarily a result of the \$21.7 million increase in trade receivables, partially offset by the \$3.7 increase in the amount

outstanding under the line of credit portion of the Facility.

Performance Metrics

| | September 30, 2010 | September 30, 2009 | Increase (Decrease) |
|---------------------------|-----------------------|-----------------------|------------------------|
| | | (in Days) | |
| Days of sales outstanding | 57.4 | 50.4 | 7.0 |
| Inventory turns | 6.6 | 4.7 | 1.9 |

Accounts receivable days of sales outstanding were 57.4 days at September 30, 2010 compared to 50.4 days at September 30, 2009. The increase resulted primarily from a change in customer mix, which resulted in slower collection of accounts receivable. Annualized inventory turns were 6.6 at September 30, 2010 and 4.7 at September 30, 2009. The increase in inventory turns resulted from the reduction in inventories, including the \$13.8 million adjustment recorded in 2009 to reduce the value of inventory acquired in the acquisition of Precision Industries, Inc. ("Precision").

Funding Commitments

We believe our cash generated from operations and borrowings available under the Facility will meet our normal working capital needs during the next 12 months. However, we may require additional debt or equity financing to fund potential acquisitions. Such additional financings may include additional bank debt or the public or private sale of debt or equity securities. In connection with any such financing, we may issue securities that substantially dilute the interests of our shareholders. We may not be able to obtain additional financing on attractive terms, if at all.

Acquisitions

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

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant estimates made by us in the accompanying financial statements relate to reserves for accounts receivable collectability, inventory valuations, income taxes, self-insured liability claims and self-insured medical claims. Actual results could differ from those estimates. Management periodically re-evaluates these estimates as events and circumstances change. Together with the effects of the matters discussed above, these factors may significantly impact the Company's results of operations from period to period.

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

believe are our critical accounting policies.

Revenue Recognition

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

Allowance for Doubtful Accounts

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

Inventory

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

Self-insured Insurance and Medical Claims

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

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

The accrual for these claims at December 31, 2009 and September 30, 2010 was approximately \$1.3 million and \$1.9 million, respectively.

Impairment of Long-Lived Assets and Goodwill

Goodwill represents a significant portion of our total assets. We review goodwill for impairment annually during our fourth quarter or more frequently if certain impairment indicators arise under the provisions of authoritative accounting guidance. We review goodwill at the reporting level unit, which is one level below an operating segment. We review the carrying value of the net assets of each reporting unit to the net present value of estimated discounted future cash flows of the reporting unit. If the carrying value exceeds the net present value of estimated discounted future cash flows, an impairment indicator exists and an estimate of the impairment loss is calculated. The fair value calculation includes multiple assumptions and estimates, including the projected cash flows and discount rates applied. Changes in these assumptions and estimates could result in goodwill impairment that could materially and adversely impact our financial position or results of operations. Assets, liabilities, deferred taxes and goodwill for each reporting unit are determined using the balance sheets maintained for each reporting unit.

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

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

Purchase Accounting

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

Cost of Sales and Selling, General and Administrative Expense

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

Income Taxes

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk results from volatility in interest rates. Our exposure to interest rate risk relates primarily to our debt portfolio. Using our floating interest rate debt outstanding at September 30, 2010, a 100 basis point change in interest rates would result in approximately a \$1,075,000 change in annual interest expense.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Report, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") was evaluated by our management with the participation of our President and Chief Executive Officer, David R. Little (principal executive officer), and our Senior Vice President and Chief Financial Officer, Mac McConnell (principal financial officer). Such disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission ("SEC")'s rules and forms, and is accumulated and communicated to the Company's management, including its principal executive and principal financial officers as appropriate to allow timely decisions regarding required disclosure. Messrs. Little and McConnell have concluded that our disclosure controls and procedures are effective, as of the end of the period covered by this Report, to help ensure that information we are required to disclose in reports that we file with the SEC is accumulated and communicated to management and recorded, processed, summarized and reported within the time periods prescribed by the SEC.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter (the quarter ended September 30, 2010) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

No material developments have occurred in the asbestos-related litigation or the litigation with BP America Production Company disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the SEC on March 23, 2010 (the "Annual Report").

ITEM 6. EXHIBITS

3.1 Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the SEC on August 20, 1998).

3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4 (Reg. No. 333-10021), filed with the SEC on August 12, 1996).

4.1 Form of Common Stock certificate (incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the SEC on August 20, 1998).

4.2 See Exhibit 3.1 for provisions of the Registrant's Restated Articles of Incorporation, as amended, defining the rights of security holders.

4.3 See Exhibit 3.2 for provisions of the Registrant's Bylaws defining the rights of security holders.

4.4 Form of Senior Debt Indenture of DXP Enterprises, Inc. (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-3 (Reg. No. 333-166582), filed with the SEC on May 6, 2010).

4.5 Form of Subordinated Debt Indenture of DXP Enterprises, Inc. (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-3 (Reg. No. 333-166582), filed with the SEC on May 6, 2010).

10.1 Asset Purchase Agreement, dated as of April 1, 2010, whereby DXP Enterprises, Inc. acquired the assets of Quadna (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 5, 2010).

10.2 Convertible Promissory Note dated April 1, 2010 in the amount of \$3,400,000.00 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 8, 2010).

10.3 Convertible Promissory Note dated April 1, 2010 in the amount of \$2,100,000.00 (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 8, 2010).

10.4 Convertible Promissory Note dated April 1, 2010 in the amount of \$4,500,000.00 (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 8, 2010).

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith).

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DXP ENTERPRISES, INC.

(Registrant)

By: /s/MAC McCONNELL

Mac McConnell

Senior Vice-President/Finance and

Chief Financial Officer

Date: November 8, 2010

