

DXP ENTERPRISES INC  
Form 10-Q  
August 07, 2008

---

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

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the quarterly period ended June 30, 2008

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

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

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

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

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 Act). Yes  No

Number of shares of registrant's Common Stock outstanding as of August 9, 2008: 6,399,560.

PART I: FINANCIAL INFORMATION  
ITEM 1: FINANCIAL STATEMENTS

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

ASSETS	June 30, 2008 (unaudited)	December 31, 2007 (Restated)
<b>Current assets:</b>		
Cash	\$ 5,960	\$ 3,978
Trade accounts receivable, net of allowances for doubtful accounts of \$2,409 in 2008 and \$2,131 in 2007	96,626	79,969
Inventories, net	89,883	86,200
Prepaid expenses and other current assets	2,254	1,650
Deferred income taxes	2,084	1,791
Total current assets	196,807	173,588
Property and equipment, net	18,418	17,119
Goodwill	61,710	60,849
Other intangibles, net of accumulated amortization of \$5,702 in 2008 and \$3,242 in 2007	33,671	35,852
Other assets	995	762
Total assets	\$ 311,601	\$ 288,170
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Current portion of long-term debt	\$ 3,894	\$ 4,200
Trade accounts payable	65,221	55,020
Accrued wages and benefits	9,897	10,001
Customer advances	1,650	3,684
Federal income taxes payable	1,522	2,510
Other accrued liabilities	6,161	5,654
Total current liabilities	88,345	81,069
Other liabilities	150	-
Long-term debt, less current portion	105,803	101,989
Deferred income taxes	2,567	2,387
Minority interest in consolidated subsidiary	12	12
<b>Commitments and contingencies</b>		
<b>Shareholders' equity:</b>		
Series A preferred stock, 1/10th vote per share; \$1.00 par value; liquidation preference of \$100 per share (\$112 at June 30, 2008); 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 June 30, 2008); 1,000,000 shares authorized;	15	15

Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

15,000 shares issued and outstanding

Common stock, \$0.01 par value, 100,000,000 shares authorized; 6,325,072 in 2008 and 6,322,072 in 2007 shares outstanding	63	63
Paid-in capital	55,152	54,697
Retained earnings	60,528	48,762
Other comprehensive income, net of income taxes	(210)	-
Treasury stock; 20,049 common shares, at cost	(825)	(825)
Total shareholders' equity	114,724	102,713
Total liabilities and shareholders' equity	\$ 311,601	\$ 288,170

See notes to the condensed consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Sales	\$ 187,802	\$ 85,323	\$ 356,301	\$ 168,954
Cost of sales	135,926	60,812	258,479	119,506
Gross profit	51,876	24,511	97,822	49,448
Selling, general and administrative expense	40,391	18,416	75,769	36,647
Operating income	11,485	6,095	22,053	12,801
Other income	27	81	40	99
Interest expense	(1,176)	(517)	(2,559)	(1,107)
Income before income taxes	10,336	5,659	19,534	11,793
Provision for income taxes	3,963	2,242	7,722	4,649
Net income	6,373	3,417	11,812	7,144
Preferred stock dividend	(22)	(22)	(45)	(45)
Net income attributable to common shareholders	\$ 6,351	\$ 3,395	\$ 11,767	\$ 7,099
Basic income per share	\$ 1.00	\$ 0.61	\$ 1.86	\$ 1.32
Weighted average common shares outstanding	6,325	5,600	6,324	5,366
Diluted income per share	\$ 0.93	\$ 0.56	\$ 1.73	\$ 1.20
Weighted average common and common equivalent shares outstanding	6,846	6,111	6,840	5,936

See notes to condensed consolidated financial statements.

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

	SIX MONTHS ENDED	
	JUNE 30,	
	2008	2007
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 11,812	\$ 7,144
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation	2,036	652
Amortization of intangibles	2,460	836
Compensation expense on stock options and restricted stock	454	250
Deferred income taxes	(113)	(132)
Gain on sale of property and equipment	-	(8)
Tax benefit related to exercise of stock options	-	(2,968)
Changes in operating assets and liabilities:		
Trade accounts receivable	(15,532)	(3,910)
Inventories	(312)	1,477
Prepaid expenses and other current assets	1,896	3,742
Accounts payable and accrued liabilities	6,500	(3,816)
Net cash provided by operating activities	5,409	3,267
<b>INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(3,202)	(989)
Proceeds from the sale of property and equipment	-	8
Purchase of businesses, net of cash acquired	(3,822)	(9,377)
Net cash used in investing activities	(7,024)	(10,358)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from debt	25,223	48,123
Principal payments on revolving line of credit and other long-term debt	(21,581)	(75,707)
Dividends paid in cash	(45)	(45)
Proceeds from exercise of stock options	-	191
Proceeds from sale of common stock	-	44,639
Tax benefit related to exercise of stock options	-	2,968
Net cash provided by financing activities	3,597	20,169
<b>INCREASE IN CASH</b>	<b>1,982</b>	<b>13,078</b>
<b>CASH AT BEGINNING OF PERIOD</b>	<b>3,978</b>	<b>2,544</b>
<b>CASH AT END OF PERIOD</b>	<b>\$ 5,960</b>	<b>\$ 15,622</b>

See notes to condensed consolidated financial statements.



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

NOTE 1: BASIS OF PRESENTATION

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

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission.

NOTE 2: THE COMPANY

DXP, a Texas corporation, was incorporated on July 26, 1996, to be the successor to SEPCO Industries, Inc. (SEPCO). The Company is organized into two segments: Maintenance, Repair and Operating (MRO) and Electrical Contractor.

NOTE 3: NEW ACCOUNTING PRONOUNCEMENTS

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS No. 157 are effective for the fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-2, which delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those years for all nonfinancial assets and nonfinancial liabilities, except those that are recognized at fair value in the financial statements on a recurring basis (at least annually). See Note 11 "Fair Value of Financial Assets and Liabilities" for additional information on the adoption of SFAS 157. The Company is evaluating the effect that implementation of SFAS 157 for its nonfinancial assets and nonfinancial liabilities will have on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) requires the acquiring entity in a business combination to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. In addition, immediate expense recognition is required



for transaction costs. SFAS 141(R) is effective for financial statements issued for fiscal years beginning after December 15, 2008, and adoption is prospective only. As such, if the Company enters into any business combinations after adoption of SFAS 141(R), a transaction may significantly affect the Company's financial position and earnings, but, not cash flows, compared to the Company's past acquisitions.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 requires entities to report noncontrolling (minority) interest as a component of shareholders' equity on the balance sheet; and include all earnings of a consolidated subsidiary in consolidated results of operations. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and adoption is prospective only; however, presentation and disclosure requirements must be applied retrospectively. The Company has not yet determined the effect, if any; SFAS 160 will have on its financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133” (“SFAS 161”) SFAS 161 amends and expands the disclosure requirements of Statement 133 to provide a better understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and their effect on an entity’s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008. The Company has not yet determined the effect, if any; SFAS 161 will have on its financial statements.

#### NOTE 4: ACCOUNTING METHODS ADOPTED JANUARY 1, 2008

On January 1, 2008, we elected to change our costing method for our inventories accounted for on the last-in, first-out method (LIFO) to the first-in, first-out (“FIFO”) method. The percentage of total inventories accounted for under the LIFO method was approximately 46% at December 31, 2007. We believe the FIFO method is preferable as it conforms the inventory costing methods for all of our inventories to a single method. The FIFO method also better reflects current acquisition costs of those inventories on our consolidated balance sheets and enhances the matching of future cost of sales with revenues. In accordance with Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections, (“SFAS No. 154”), all prior periods presented have been adjusted to apply the new method retrospectively. The effect of the change in our inventory costing method includes the LIFO reserve and related impact on the obsolescence reserve. This change increased our inventory balance by \$2.0 million and increased retained earnings, net of income tax effects, by \$1.2 million as of January 1, 2007.

The effect of this change in accounting principle was immaterial to the results of operations for all prior periods presented. The effect of the change in accounting principle for inventory costs on the December 31, 2007 balance sheets is presented below. Certain financial statement line items are combined if they were not affected by the change in accounting principle.

	Originally Reported	December 31, 2007 Change to FIFO	Adjusted
(Dollars in thousands)			
<b>ASSETS</b>			
Current assets			
Inventories	\$ 84,196	\$ 2,004	\$ 86,200
Other current assets	87,388	-	87,388
Total current assets	171,584	2,004	173,588
Other assets	114,582	-	114,582
Total Assets	\$ 286,166	\$ 2,004	\$ 288,170
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities			
Income taxes payable	\$ 1,708	\$ 802	\$ 2,510
Other current liabilities	78,559	-	78,559
Total current liabilities	80,267	802	81,069
Other liabilities	104,388	-	104,388
Total liabilities	184,655	802	185,457
Shareholders' equity			
Retained earnings	47,560	1,202	48,762

Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

Other shareholders' equity	53,951	-	53,951
Total shareholders' equity	101,511	1,202	102,713
Total liabilities and shareholders' equity	\$ 286,166	\$ 2,004	\$ 288,170

6

---

On January 1, 2007, we also changed our accounting method from the completed-contract method to the percentage of completion method for binding agreements to fabricate tangible assets to customers' specifications in accordance with Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type contracts. The percentage-of-completion method presents the economic substance of these transactions more clearly and timely than the completed-contract method. The effect of this change in accounting principle was immaterial to results of operations and balance sheets for all prior periods presented. At June 30, 2008, \$9.6 million of unbilled costs and estimated earnings are included in accounts receivable.

#### NOTE 5: STOCK-BASED COMPENSATION

##### Adoption of SFAS 123(R)

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standard 123(R) "Share-Based Payment" ("SFAS 123(R)") using the modified prospective transition method. In addition, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin No. 107 "Share-Based Payment" ("SAB 107") in March 2005, which provides supplemental SFAS 123(R) application guidance based on the views of the SEC. Under the modified prospective transition method, compensation cost recognized in each quarterly period ended after January 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted beginning January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R).

##### Stock Options as of the Six Month Period Ended June 30, 2008

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 June 30, 2008, all outstanding options were non-qualified stock options.

The following table summarizes stock options outstanding and changes during the six month period ended June 30, 2008:

	Options Outstanding and Exercisable			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2007	111,226	\$ 2.15	3.2	\$ 4,953,000
Granted	-			
Exercised	-			
Options outstanding and exercisable at June 30, 2008	111,226	\$ 2.15	2.7	\$ 4,392,000

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 six month period ended June 30, 2008, was zero. Cash received from stock options exercised during the six month period ended June 30, 2008 was zero.

Stock options outstanding and currently exercisable at June 30, 2008 are as follows:

Options Outstanding and Exercisable			
Range of exercise prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$ 1 . 0 0 -			
\$2.50	91,226	1.8	\$1.39
\$ 4 . 5 3 -			
\$6.72	20,000	6.4	\$5.62
	111,226	2.7	\$2.15

## Restricted Stock.

Under a 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 stock granted to employees as of June 30, 2008 vest 20% each year for five years after the grant date or 10% each year for ten years after the grant date. The Restricted Stock Plan provides that on each July 1 during the term of the plan each non-employee director of DXP will be granted the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on such July 1. The shares of restricted stock granted to non-employee directors of DXP vest one year after the grant date. The fair value of restricted stock awards is measured based upon the closing prices of DXP's common stock on the grant dates and is recognized as compensation expense over the vesting period of the awards.

The following table provides certain information regarding the shares authorized and outstanding under the Restricted Stock Plan at June 30, 2008:

Number of shares	300,000
authorized for	
grants	
Number of shares	124,258
granted	
Number of shares	175,742
available for future	
grants	
Weighted-average	\$ 32.72
grant price of	
granted shares	

Changes in restricted stock for the six months ended June 30, 2008 were as follows:

	Number of Shares	Weighted Average Grant Price
Unvested at	106,226	\$ 33.63
December		
31, 2007		
Granted	-	-
Vested	3,000	\$ 18.85
Unvested at	103,226	\$ 34.06
June 30,		
2008		

Compensation expense, associated with restricted stock, recognized in the six months ended June 30, 2008 and 2007 was \$454,000 and \$250,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$2,810,000 and \$3,264,000 at June 30, 2008 and December 31, 2007, respectively. As of June 30, 2008, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 37 months.

## NOTE 6: INVENTORY

Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

As noted in Note 4, effective January 1, 2008, DXP elected to change its costing method for selected inventories. DXP applied this change in accounting principle by adjusting all prior period balance sheets presented retrospectively. Inventories are valued at the lower of cost or market utilizing the first-in, first-out method to determine cost. The carrying values of inventories are as follows (in thousands):

	June 30, 2008	December 31, 2007 (Restated)
Finished goods	\$ 88,419	\$ 82,198
Work in process	1,464	4,002
Inventories	\$ 89,883	\$ 86,200

## Note 7: GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill and other intangibles during the six months ended June 30, 2008 are as follows (in thousands):

	Total	Goodwill	Other Intangibles
Balance as of December 31, 2007	\$ 96,701	\$ 60,849	\$ 35,852
Acquired during the year	854	575	279
Adjustments to prior year estimates	286	286	-
Amortization	(2,460)	-	(2,460)
Balance as of June 30, 2008	\$ 95,381	\$ 61,710	\$ 33,671

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

	As of June 30, 2008		As of December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Vendor agreements	\$ 3,773	\$ ( 487)	\$ 3,773	\$ (393)
Customer relationships	34,063	( 4,753)	33,804	(2,632)
Non-compete agreements	1,537	(462)	1,517	(217)
Total	\$ 39,373	\$ (5,702)	\$ 39,094	\$ (3,242)

The \$0.9 million increase in goodwill and the \$0.3 million increase in other intangibles from December 31, 2007 to June 30, 2008 results from recording the estimated intangibles for the acquisition of the business of Rocky Mountain Supply and changes in the estimates of goodwill for businesses acquired during 2007. Other intangible assets are generally amortized on a straight line basis over the useful lives of the assets. All goodwill and other intangible assets pertain to the MRO segment.

## NOTE 8. 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		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Basic:				
Weighted average shares outstanding	6,325,072	5,600,134	6,324,116	5,366,026
Net income	\$ 6,373,000	\$3,417,000	\$11,812,000	\$7,144,000
Convertible preferred stock dividend	(22,000)	(22,000)	(45,000)	(45,000)
	\$ 6,351,000	\$3,395,000	11,767,000	\$7,099,000



Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

Net income attributable to common  
shareholders

Per share amount	\$ 1.00	\$ 0.61	\$ 1.86	\$ 1.32
------------------	---------	---------	---------	---------

Diluted:

Weighted average shares outstanding	6,325,072	5,600,134	6,324,116	5,366,026
-------------------------------------	-----------	-----------	-----------	-----------

Net effect of dilutive stock options – based on the treasury stock method	100,485	91,154	96,142	149,845
--	---------	--------	--------	---------

Assumed conversion of convertible preferred stock	420,000	420,000	420,000	420,000
--	---------	---------	---------	---------

preferred stock

Total	6,845,557	6,111,288	6,840,258	5,935,871
-------	-----------	-----------	-----------	-----------

Net income attributable to common shareholders	\$ 6,350,000	\$3,395,000	\$11,767,000	\$7,099,000
---	--------------	-------------	--------------	-------------

shareholders

Convertible preferred stock dividend	23,000	22,000	45,000	45,000
--------------------------------------	--------	--------	--------	--------

Net income for diluted earnings per share	\$ 6,373,000	\$3,417,000	\$11,812,000	\$7,144,000
---	--------------	-------------	--------------	-------------

Per share amount	\$ 0.93	\$ 0.56	\$ 1.73	\$ 1.20
------------------	---------	---------	---------	---------

## NOTE 9: SEGMENT REPORTING

The MRO Segment is engaged in providing maintenance, repair and operating products, equipment and integrated services, including engineering expertise and logistics capabilities, to industrial customers. The Company provides a wide range of MRO products in the fluid handling equipment, bearing, power transmission equipment, general mill, safety supply and electrical products categories. The Electrical Contractor segment sells a broad range of electrical products, such as wire conduit, wiring devices, electrical fittings and boxes, signaling devices, heaters, tools, switch gear, lighting, lamps, tape, lugs, wire nuts, batteries, fans and fuses, to electrical contractors.

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

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

	Three Months ended June 30,			Six Months ended June 30,		
	MRO	Electrical Contractor	Total	MRO	Electrical Contractor	Total
2008						
Sales	\$ 186,823	\$ 979	\$187,802	\$ 354,419	\$ 1,882	\$ 356,301
Operating income	11,315	170	11,485	21,742	311	22,053
Income before taxes	10,199	137	10,336	19,286	248	19,534
2007						
Sales	\$ 84,555	\$ 768	\$ 85,323	\$ 167,421	\$ 1,533	\$ 168,954
Operating income	5,983	112	6,095	12,641	160	12,801
Income before taxes	5,573	86	5,659	11,686	107	11,793

## NOTE 10: ACQUISITIONS

All of the Company's acquisitions have been accounted for using the purchase method of accounting. Revenues and expenses of the acquired businesses have been included in the accompanying consolidated financial statements beginning on their respective dates of acquisition. The allocation of purchase price to the acquired assets and liabilities is based on estimates of fair market value and may be prospectively revised if and when additional information the Company is awaiting concerning certain asset and liability valuations is obtained, provided that such information is received no later than one year after the date of acquisition.

On September 10, 2007, DXP completed the acquisition of Precision Industries, Inc. DXP acquired this business to expand DXP's geographic presence and strengthen DXP's integrated supply offering. The Company paid \$106 million in cash for Precision Industries, Inc. The purchase price was funded using approximately \$24 million of cash on hand and approximately \$82 million borrowed from a new \$130 million credit facility.

On October 19, 2007, DXP completed the acquisition of the business of Indian Fire & Safety. DXP acquired this business to strengthen DXP's expertise in safety products and services in New Mexico and Texas. DXP paid \$6.0 million in cash, \$3.0 million in the form of a promissory note and \$3.0 million in future payments contingent upon

earnings for the business of Indian Fire & Safety. The cash portion was funded by utilizing available capacity under DXP's credit facility.

On February 1, 2008, DXP completed the acquisition of the business of Rocky Mtn. Supply, Inc. DXP acquired this business to expand DXP's geographic presence in Colorado. DXP paid approximately \$4.6 million, net of acquired cash, for this business. The purchase price consisted of approximately \$3.9 million paid in cash and \$0.7 million in the form of promissory notes. The cash portion was funded by utilizing available capacity under DXP's credit facility.

The allocation of purchase price for all acquisitions completed since June 30, 2007 are preliminary in the June 30, 2008 consolidated balance sheets. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in the estimates of the fair value of assets acquired and liabilities assumed. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed since June 30, 2007 in connection with the acquisitions described above (in thousands).

Cash	\$ 698
Accounts Receivable	28,321
Inventory	42,186
Property and equipment	7,437
Goodwill and intangibles	69,799
Other assets	2,692
Assets acquired	151,133
Current liabilities assumed	(27,372)
Non-current liabilities assumed	(333)
Net assets acquired	\$123,428

The pro forma unaudited results of operations for the Company on a consolidated basis for the three months and six months ended June 30, 2008 and 2007, assuming the purchases completed in 2007 and 2008 were consummated as of January 1 of each year follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Unaudited)			
	(In Thousands, except for per share data)			
Net Sales	\$187,802	\$ 160,260	\$357,380	\$326,343
Net Income	\$ 6,373	\$ 4,325	\$ 11,841	\$ 9,371
Per share data				
Basic earnings	\$ 1.00	\$ 0.65	\$ 1.87	\$ 1.47
Diluted earnings	\$ 0.93	\$ 0.61	\$ 1.73	\$ 1.36

NOTE 11: FAIR VALUE OF FINANCIAL INSTRUMENTS

We adopted SFAS 157 effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. SFAS 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. In February 2008, the FASB issued FSP 157-2, which delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and liabilities. Fair value, as defined in SFAS 157, 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. SFAS 157 affects the Company in the fair value measurement of the commodity and interest rate derivative positions 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. This includes: 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.

As required by SFAS 157, 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 table summarizes the valuation of our financial instruments by SFAS 157 input levels as of June 30, 2008:

Fair Value Measurement (in thousands)				
Description (Liabilities)	Level 1	Level 2	Level 3	Total
Current liabilities	\$ -	\$ 200	\$ -	\$ 200
Non-current liabilities	-	150	-	150
Total	\$ -	\$ 350	\$ -	\$ 350

## NOTE 12: COMPREHENSIVE INCOME

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 comprehensive income related to changes in interest rates in connection with an interest rate swap, which is recorded as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	\$ 6,373	\$ 3,417	\$ 11,812	\$ 7,144
Gain (loss) from interest rate swap, net of income taxes	390	-	(210)	-
Comprehensive income	\$ 6,763	\$ 3,417	\$ 11,602	\$ 7,144

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

## RESULTS OF OPERATIONS

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	%	2007	%	2008	%	2007	%
(in thousands, except percentages and per share amounts)								
Sales	\$187,802	100.0	\$85,323	100.0	\$356,301	100.0	\$168,954	100.0
Cost of sales	135,926	72.4	60,812	71.3	258,479	72.5	119,506	70.7
Gross profit	51,876	27.6	24,511	28.7	97,822	27.5	49,448	29.3
Selling, general and administrative expense	40,391	21.5	18,416	21.6	75,769	21.3	36,647	21.7
Operating income	11,485	6.1	6,095	7.1	22,053	6.2	12,801	7.6
Interest expense	(1,176)	(0.6)	(517)	(0.6)	(2,559)	(0.7)	(1,107)	(0.7)

Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

Other income	27	-	81	0.1	40	-	99	0.1
Income before income taxes	10,336	5.5	5,659	6.6	19,534	5.5	11,793	7.0
Provision for income taxes	3,963	2.1	2,242	2.6	7,722	2.2	4,649	2.8
Net income	\$ 6,373	3.4	\$ 3,417	4.0	11,812	3.3	\$ 7,144	4.2
Per share amounts								
Basic earnings per share	\$ 1.00		\$ 0.61		\$1.86		\$ 1.32	
Diluted earnings per share	\$ 0.93		\$ 0.56		\$1.73		\$ 1.20	

Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007

**SALES.** Revenues for the quarter ended June 30, 2008, increased \$102.5 million, or 120.1%, to approximately \$187.8 million from \$85.3 million for the same period in 2007. Sales for the MRO Segment increased \$102.3 million, or 120.9%, primarily due to sales by businesses acquired in 2007 and 2008. Sales by businesses acquired since March 31, 2007 accounted for \$76.1 million of the 2008 sales increase. Excluding sales of the acquired businesses, sales for the MRO segment increased 30.9%. This sales increase is primarily due to a broad based increase in sales of pumps, bearings, safety products and mill supplies to companies engaged in oilfield service, oil and gas production, mining, electricity generation and petrochemical processing. Sales for the Electrical Contractor segment increased by \$0.2 million, or 27.5%, for the current quarter when compared to the same period in 2007. The sales increase resulted from the sale of more commodity type electrical products.

**GROSS PROFIT.** Gross profit as a percentage of sales decreased by approximately 1.1% for the second quarter of 2008, when compared to the same period in 2007. Gross profit as a percentage of sales for the MRO segment decreased to 27.6% for the three months ended June 30, 2008, from 28.6% in the comparable period of 2007. This decrease can be primarily attributed to the lower gross profit on sales by Precision which was acquired on September 10, 2007. Gross profit as a percentage of sales for the Electrical Contractor segment decreased to 36.3% for the three months ended June 30, 2008, from 39.2% in the comparable period of 2007. This decrease resulted from increased sales of lower margin commodity type electrical products.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the quarter ended June 30, 2008, increased by approximately \$22.0 million when compared to the same period in 2007. The increase is primarily attributed to increased selling, general and administrative expenses of acquired businesses. Selling, general and administrative expense associated with businesses acquired since March 31, 2007 accounted for \$16.2 million of the \$22.0 million increase. The remaining \$5.8 million of the increase is primarily the result of increased salaries, incentive compensation, employee benefits and payroll related expenses. These expenses have increased partially as a result of increased profits, which increased incentive compensation, and hiring more sales related personnel for the purpose of increasing sales. As a percentage of revenue, the 2008 expense decreased by approximately 0.1%, to 21.5%, from 21.6% for the quarter ended June 30, 2007. This decrease is primarily the result of economies of scale.

**OPERATING INCOME.** Operating income for the three months ended June 30, 2008 increased 88.4% when compared to the same period in 2007. Operating income for the MRO segment increased 89.1% as a result of increased gross profit, partially offset by increased selling, general and administrative expense. Operating income for the Electrical Contractor segment increased 51.8% primarily as a result of increased gross profit.

**INTEREST EXPENSE.** Interest expense for the quarter ended June 30, 2008 increased by 127.5% from the same period in 2007. This increase results from increased debt used to fund acquisitions, partially offset by an approximate 260 basis point decrease in market interest rates on floating rate debt.

Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007

**SALES.** Revenues for the six months ended June 30, 2008, increased \$187.3 million, or 110.9%, to approximately \$356.3 million from \$169.0 million for the same period in 2007. Sales for the MRO Segment increased \$187.0 million, or 111.7%, primarily due to sales by businesses acquired since March 31, 2007. Sales by these acquired businesses accounted for \$149.7 million of the 2008 sales increase. Excluding sales of the acquired businesses, sales for the MRO segment increased 22.3%. This sales increase is primarily due to a broad based increase in sales of pumps, bearings, safety products and mill supplies to companies engaged in oilfield service, oil and gas production, mining, electricity generation and petrochemical processing. Sales for the Electrical Contractor segment increased by \$0.3 million, or 22.8%, for the first six months of 2008 when compared to the same period in 2007. The sales increase



resulted from the sale of more specialty and commodity type electrical products.

**GROSS PROFIT.** Gross profit as a percentage of sales decreased by approximately 1.8% for the first six months of 2008, when compared to the same period in 2007. Gross profit as a percentage of sales for the MRO segment decreased to 27.4% for the six months ended June 30, 2008, from 29.2% in the comparable period of 2007. This decrease can be primarily attributed to the lower gross profit on sales by Precision which was acquired on September 10, 2007. Gross profit as a percentage of sales for the Electrical Contractor segment increased to 36.5% for the six months ended June 30, 2008, from 35.9% in the comparable period of 2007. This increase resulted from increased sales of higher margin specialty type electrical products.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the first six months ended June 30, 2008, increased by approximately \$39.1 million when compared to the same period in 2007. The increase is primarily attributed to increased selling, general and administrative expenses of acquired businesses. Selling, general and administrative expense associated with businesses acquired since March 31, 2007 accounted for \$32.0 million of the \$39.1 million increase. The remaining \$7.1 million of the increase is primarily the result of increased salaries, incentive compensation, employee benefits and payroll related expenses. These expenses have increased partially as a result of increased profits, which increased incentive compensation, and hiring more sales related personnel for the purpose of increasing sales. As a percentage of revenue, the 2008 expense decreased by approximately 0.4%, to 21.3%, from 21.7% for the six months ended June 30, 2007. This decrease is primarily the result of economies of scale.

**OPERATING INCOME.** Operating income for the first six months of 2008 increased 72.3% when compared to the same period in 2007. Operating income for the MRO segment increased 72.0% as a result of increased gross profit, partially offset by increased selling, general and administrative expense. Operating income for the Electrical Contractor segment increased 94.4% primarily as a result of increased gross profit.

**INTEREST EXPENSE.** Interest expense for the six months ended June 30, 2008 increased by 131.2% from the same period in 2007. This increase results from increased debt used to fund acquisitions, partially offset by an approximate 230 basis point decrease in market interest rates on floating rate debt.

#### Acquisitions

All of the Company's acquisitions have been accounted for using the purchase method of accounting. Revenues and expenses of the acquired businesses have been included in the accompanying consolidated financial statements beginning on their respective dates of acquisition. The allocation of purchase price to the acquired assets and liabilities is based on estimates of fair market value and may be prospectively revised if and when additional information the Company is awaiting concerning certain asset and liability valuations is obtained, provided that such information is received no later than one year after the date of acquisition.

On September 10, 2007, DXP completed the acquisition of Precision Industries, Inc. DXP acquired this business to expand DXP's geographic presence and strengthen DXP's integrated supply offering. The Company paid \$106 million in cash for Precision Industries, Inc. The purchase price was funded using approximately \$24 million of cash on hand and approximately \$82 million borrowed from a new \$130 million credit facility.

On October 19, 2007, DXP completed the acquisition of the business of Indian Fire & Safety. DXP acquired this business to strengthen DXP's expertise in safety products and services in New Mexico and Texas. DXP paid \$6.0 million in cash, \$3.0 million in the form of a promissory note and \$3.0 million in future payments contingent upon earnings for the business of Indian Fire & Safety. The cash portion was funded by utilizing available capacity under DXP's credit facility.

On February 1, 2008, DXP completed the acquisition of the business of Rocky Mtn Supply, Inc. DXP acquired this business to expand DXP's geographic presence in Colorado. DXP paid approximately \$4.6 million, net of acquired cash, for this business. The purchase price consisted of approximately \$3.9 million paid in cash and \$0.7 million in the form of promissory notes. The cash portion was funded by utilizing available capacity under DXP's credit facility.

The allocation of purchase price for all acquisitions completed since June 30, 2007 are preliminary in the June 30, 2008 consolidated balance sheets. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in the estimates of the fair value of assets acquired and liabilities assumed. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed since June 30, 2007 in

connection with the acquisitions described above (in thousands).

Cash	\$
	698
Accounts Receivable	28,321
Inventory	42,186
Property and equipment	7,437
Goodwill and intangibles	69,799
Other assets	2,692
Assets acquired	151,133
Current liabilities assumed	(27,372)
Non-current liabilities assumed	(333)
Net assets acquired	\$ 123,428

The pro forma unaudited results of operations for the Company on a consolidated basis for the six months ended June 30, 2008 and 2007, assuming the purchases completed in 2007 and 2008 were consummated as of January 1 of each year follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Unaudited)			
	(in thousands, except for per share data)			
Net sales	\$187,802	\$160,260	\$357,380	\$326,343
Net income	6,373	4,325	11,841	9,371
Per share data				
Basic earnings	\$1.01	\$0.65	\$1.87	\$1.47
Diluted earnings	\$0.93	\$0.61	\$1.73	\$1.36

## LIQUIDITY AND CAPITAL RESOURCES

### General Overview

As a distributor of MRO products and Electrical Contractor 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 \$5.6 million of cash in operating activities during the first six months of 2008 as compared to generating \$3.3 million during the first six months of 2007. This change between the two periods was primarily attributable to increased net income and amortization of intangibles in the 2008 period, increased accounts payable in the 2008 period and a \$3.0 million use of cash recorded for the tax benefit related to the exercise of stock options in the 2007 period.

During the first six months of 2008, the amount available to be borrowed under our loan agreement with our bank lenders (the "Credit Facility") increased from \$17.1 million at December 31, 2007 to \$29.6 million at June 30, 2008. This increase in availability primarily resulted from increased accounts receivable and inventory.

#### Credit Facility

On September 10, 2007, DXP entered into the Credit Facility with Wells Fargo Bank, National Association as lead arranger and administrative agent. The Credit Facility consists of a revolving credit facility that provides a \$130 million line of credit to DXP. This new line of credit replaced DXP's prior credit facility. The Credit Facility expires on September 10, 2012.

DXP's borrowings and letters of credit outstanding under the Credit Facility as of any day must be less than the sum of 85% of net accounts receivable; 50% of the net book value of furniture, fixtures and equipment; and 60% of inventory. DXP's borrowings and letter of credit capacity under the Credit Facility at any given time is \$130 million less borrowings and letters of credit outstanding, subject to the asset coverage ratio described above.

The Credit Facility is secured by receivables, inventory, fixed assets and intangibles. The Credit Facility contains customary affirmative and negative covenants as well as financial covenants that are measured quarterly and require that we comply with certain financial covenants described below.

The Credit Facility allows us to borrow at LIBOR plus a margin ranging from 0.75% to 1.25% or prime plus a margin of 0.00% to 0.25%. At June 30, 2008, the LIBOR based rate was LIBOR plus 0.75 basis points. At June 30, 2008, the prime based rate was prime plus zero percent. At June 30, 2008, \$99.4 million was outstanding under the Credit Facility. At June 30, 2008, \$98.0 million was borrowed at a weighted average interest rate of 3.23% under the LIBOR option and \$1.4 million was borrowed at an interest rate of 5.0% under the prime option. Commitment fees of 0.125% to 0.25% per annum are payable on the portion of the Credit Facility capacity not in use for borrowings at any given time. At June 30, 2008 the commitment fee was 0.125%. At June 30, 2008, we were in compliance with all covenants under the Credit Facility.

To hedge a portion of our floating rate debt, as of January 10, 2008 DXP entered into an interest rate swap agreement with our lead bank. Through January 11, 2010 this interest rate swap effectively fixes the interest rate on \$40 million of floating rate LIBOR borrowings under the Credit Facility at 3.68% plus the margin in effect under the Credit Facility.

The Credit Facility's principal financial covenants include:

**Fixed Charge Coverage Ratio** – The Credit Facility requires that DXP's Fixed Charge Coverage Ratio be not less than 1.5 to 1.0 as of each fiscal quarter end, determined on a rolling four quarters basis, with "Fixed Charge Coverage Ratio" defined as the ratio of (a) EBITDA minus capital expenditures (excluding acquisitions) to (b) Fixed Charges. EBITDA is defined as consolidated net income plus depreciation, amortization, other non-cash expense items, interest expense, income tax expense with pro forma EBITDA adjustments for divestitures and acquisitions. Fixed Charges are defined as the aggregate of interest expense, scheduled principal payments on long term debt, current portion of capital lease obligations and cash income taxes.

**Leverage Ratio** - The Credit Facility requires that the DXP's ratio of Indebtedness to EBITDA, determined on a rolling four quarters basis, not to exceed 3.5 to 1.0 as of each quarter end until and including September 30, 2009 and 3.0 to 1.0 as of each quarter end after September 30, 2009. Indebtedness includes the sum of all obligations for borrowed money, all capital lease obligations, all guarantees of indebtedness of others and all outstanding letters of credit.

#### Borrowings

	June 30, 2008	December 31, 2007	Increase (Decrease)
	(in Thousands)		
Current portion of long-term debt	\$ 3,894	\$ 4,200	\$ (306)
Long-term debt, less current portion	105,803	101,989	3,814
Total long-term debt	\$ 109,697	\$ 106,189	\$ 3,508(2)
Amount available	\$ 29,593(1)	\$ 17,116(1)	\$ 12,477(3)

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

(2) The funds obtained from the increase in long-term debt were primarily used to fund the acquisition of the business of Rocky Mtn Supply, Inc.

(3) The \$13.4 million increase in the amount available is primarily a result of increased accounts receivable and inventory.

Performance Metrics

	June 30,		Increase
	2008	2007	(Decrease)
	(in Days)		
Days of sales outstanding	50.6	51.7	(1.1)
Inventory turns	5.9	6.5	(0.6)

Accounts receivable days of sales outstanding were 50.6 days at June 30, 2008 compared to 51.7 days at June 30, 2007. The decrease resulted primarily from a change in customer mix which resulted in faster collection of accounts receivable. Annualized inventory turns were 5.9 at June 30, 2008 compared to 6.5 at June 30, 2007. The decline in inventory turns resulted from the inclusion of businesses acquired in 2007 and 2008 which have lower inventory turns compared to the rest of DXP.

#### Funding Commitments

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

#### 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 accounts receivable collectibility, inventory valuations, income taxes, self-insured liability claims, allocation of purchase price, impairment of goodwill and other intangibles, useful lives of intangibles, and self-insured medical claims. Actual results could differ from those estimates. Management periodically re-evaluates these estimates as events and circumstances change. Together with the effects of the matters discussed above, these factors may significantly impact the Company's results of operations from period to period.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's subjective or complex judgments. 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 we recognize revenues using the percentage-of-completion method. For other sales we recognize revenues when an agreement is in place, the price is fixed, title for product passes to the customer or services have been provided, and collectibility is reasonably assured.

#### 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 collectibility of all such accounts. Write-offs could be materially different from the reserve if economic conditions change or actual results deviate from historical trends.

#### Inventory

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





#### Self-Insured Medical Claims

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. 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.

#### Self-Insured Insurance Claims

We accrue for the estimated loss on self-insured liability claims. The accrual is adjusted quarterly based upon reported claims information. The actual cost could deviate from the recorded estimate.

#### Goodwill and Other Intangible Assets

Goodwill and other intangible assets attributable to our reporting units are tested for impairment by comparing the fair value of each reporting unit with its carrying value. Significant estimates used in the determination of fair value include estimates of future cash flows, future growth rates, costs of capital and estimates of market multiples. As required under current accounting standards, we test for impairment annually at year end unless factors otherwise indicate that impairment may have occurred. We did not have any impairments under the provisions of SFAS No. 142 as of June 30, 2008.

#### Purchase Accounting

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

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

Our market risk results from volatility in interest rates. Our exposure to interest rate risk relates primarily to our debt portfolio. Using floating interest rate debt outstanding at June 30, 2008, a 100 basis point change in interest rates would result in approximately a \$1,064,000 change in annual interest expense.

To hedge a portion of our floating rate debt, on January 10, 2008, we entered into an interest-rate swap agreement with the lead bank of our Credit Facility. Through January 11, 2010, this interest rate swap effectively fixes the interest rate on \$40 million of floating rate "LIBOR" borrowings under the Credit Facility at 3.68% plus the margin in effect under the Credit Facility.

#### ITEM 4: CONTROLS AND PROCEDURES

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

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

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter (the quarter ended June 30, 2008) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In reliance on guidance set forth in Question 3 of a “Frequently Asked Questions” interpretative release issued by the staff of the SEC’s Office of the Chief Accountant and the Division of Corporation Finance in June 2004, as revised on January 21, 2005, our management determined that it would exclude Precision Industries, Inc. and its consolidated subsidiaries (“Precision”) and the businesses of Delta Process Equipment, Rocky Mtn. Supply and Indian Fire and Safety from the scope of its assessment of internal control over financial reporting as of June 30, 2008. The reason for this exclusion is that we acquired all of the stock of Precision and the businesses of Delta Process Equipment, Rocky Mtn. Supply and Indian Fire and Safety during 2007 and 2008 and it was not possible for management to conduct an assessment of internal controls over financial reporting in the period between the dates the acquisitions were completed and the date of management’s assessment. The Company has excluded Precision Industries, Inc. and the businesses of Delta Process Equipment, Rocky Mtn. Supply, and Indian Fire and Safety from its assessment of internal control over financial reporting as of June 30, 2008. The total assets and revenues of Precision Industries, Inc. and the businesses of Delta Process Equipment, Rocky Mtn. Supply, and Indian Fire and Safety represent approximately 31.4% and 43.2% respectively, of the related consolidated financial statement amounts as of and for the six months ended June 30, 2008.

#### ITEM 4: CONTROLS AND PROCEDURES

N.A.

### 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, 2007.

#### ITEM 1A. RISK FACTORS

No material changes have occurred in the risk factors disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2007.

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

None.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

#### ITEM 5. OTHER INFORMATION.

None.

#### ITEM 6. EXHIBITS

Edgar Filing: DXP ENTERPRISES INC - Form 10-Q

- 3.1 Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with Commission on August 20, 1998).
- 3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4 (Reg. No. 333-10021), filed with the Commission on August 12, 1996).
- 10.1 Asset Purchase Agreement between DXP Enterprises, Inc. and Rocky Mtn. Supply, Inc. dated as of February 1, 2008 whereby DXP acquired the assets of Rocky Mtn. Supply, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on February 7, 2008).

- 18.1 Letter of Independent Registered Accounting Firm regarding change in Accounting Principle (incorporated by reference to Exhibit 18.1 to the Registrant's Form 10-Q filed with the Commission on May 12, 2008.)
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith).
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith).

#### SIGNATURES

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

DXP ENTERPRISES, INC.

(Registrant)

By: /s/MAC McCONNELL

Mac McConnell

Senior Vice-President/Finance and

Chief Financial Officer

Dated: August 7, 2008

