

DXP ENTERPRISES INC  
Form 10-K  
March 09, 2012

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

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the fiscal year ended December 31, 2011

or

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

Commission file number 0-21513

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

Texas  
(State or other jurisdiction  
of incorporation or organization)

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

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

77040  
(Zip Code)

(713) 996-4700  
(Registrant's telephone number,  
including area code)

Securities registered pursuant to Section 12(b) of the Act: None  
Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.01 Par Value  
(Title of Class)

NASDAQ  
(Name of exchange on which registered)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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).

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Large accelerated filer [ ]

Accelerated filer

[X]

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 [X]

Aggregate market value of the registrant's Common Stock held by non-affiliates of registrant as of June 30, 2011: \$245,207,990

Number of shares of registrant's Common Stock outstanding as of March 5, 2012: 14,130,220.

Documents incorporated by reference: Portions of the definitive proxy statement for the annual meeting of shareholders to be held in 2012 are incorporated by reference into Part III hereof.

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#### DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains statements that constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “estimates”, “will”, “should”, “plans” or “anticipate” or 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.

## PART I

This Annual Report on Form 10-K (this “Report”) contains, in addition to historical information, “forward-looking statements” that involve risks and uncertainties. DXP Enterprises, Inc.'s actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors", and elsewhere in this Annual Report on Form 10-K. 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.

### ITEM 1. Business

#### Company Overview

DXP was incorporated in Texas in 1996 to be the successor to a company founded in 1908. Since our predecessor company was founded, we have primarily been engaged in the business of distributing maintenance, repair and operating (“MRO”) products, equipment and service to industrial customers. We are organized into three segments: Service Centers, Innovative Pumping Solutions and Supply Chain Services. Sales and operating income for 2009, 2010 and 2011, and identifiable assets at the close of such years for our business segments are presented in Note 14 of the Notes to the Consolidated Financial Statements.

Our total sales have increased from \$125 million in 1996 to \$807 million in 2011 through a combination of internal growth and acquisitions. At December 31, 2011 we operated from 123 locations in 34 states in the U.S. and Sonora, Mexico serving more than 50,000 customers engaged in a variety of industrial end markets. We have grown sales and profitability through a combination of additional locations, products, services and becoming customer driven experts in maintenance, repair and operating solutions.

Our principal executive office is located at 7272 Pinemont Houston, Texas 77040, and our telephone number is (713) 996-4700. Our website address on the Internet is [www.dxpe.com](http://www.dxpe.com) and emails may be sent to [info@dxpe.com](mailto:info@dxpe.com). The reference to our website address does not constitute incorporation by reference of the information contained on the website and such information should not be considered part of this report.

#### Industry Overview

The industrial distribution market is highly fragmented. Based on 2010 sales as reported by Industrial Distribution magazine, we were the 16th largest distributor of MRO products in the United States. Most industrial customers currently purchase their industrial supplies through numerous local distribution and supply companies. These distributors generally provide the customer with repair and maintenance services, technical support and application expertise with respect to one product category. Products typically are purchased by the distributor for resale directly from the manufacturer and warehoused at distribution facilities of the distributor until sold to the customer. The customer also typically will purchase an amount of product inventory for its near term anticipated needs and store those products at its industrial site until the products are used.

We believe that the distribution system for industrial products in the United States, described in the preceding paragraph, creates inefficiencies at both the customer and the distributor levels through excess inventory requirements and duplicative cost structures. To compete more effectively, our customers and other users of MRO products are seeking ways to enhance efficiencies and lower MRO product and procurement costs. In response to this customer desire, three primary trends have emerged in the industrial supply industry:

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Industry Consolidation. Industrial customers have reduced the number of supplier relationships they maintain to lower total purchasing costs, improve inventory management, assure consistently high levels of customer service and enhance purchasing power. This focus on fewer suppliers has led to consolidation within the fragmented industrial distribution industry.

- Customized Integrated Service. As industrial customers focus on their core manufacturing or other production competencies, they increasingly are demanding customized integration services, consisting of value-added traditional distribution, supply chain services, modular equipment and repair and maintenance services.
- Single Source, First-Tier Distribution. As industrial customers continue to address cost containment, there is a trend toward reducing the number of suppliers and eliminating multiple tiers of distribution. Therefore, to lower overall costs to the customer, some MRO distributors are expanding their product coverage to eliminate second-tier distributors and become a “one stop source”.

We believe we have increased our competitive advantage through our traditional and integrated supply programs, which are designed to address the customer's specific product and procurement needs. We offer our customers various options for the integration of their supply needs, ranging from serving as a single source of supply for all or specific lines of products and product categories to offering a fully integrated supply package in which we assume the procurement and management functions, including ownership of inventory, at the customer's location. Our approach to integrated supply allows us to design a program that best fits the needs of the customer. Customers purchasing large quantities of product are able to outsource all or most of those needs to us. For customers with smaller supply needs, we are able to combine our traditional distribution capabilities with our broad product categories and advanced ordering systems to allow the customer to engage in one-stop sourcing without the commitment required under an integrated supply contract.

#### Business Segments

DXP is organized under three business segments: Service Centers, Innovative Pumping Solutions (“IPS”) and Supply Chain Services (“SCS”). Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives and they provide a framework for timely and rational allocation of resources within our businesses.

#### Service Centers Segment

The Service Centers provide MRO products, equipment and services, including technical design expertise and logistics capabilities, to industrial customers with the ability to provide same day delivery. We offer our customers a single source of supply on an efficient and competitive basis by being a first-tier distributor that can purchase products directly from the manufacturer. As a first-tier distributor, we are able to reduce our customers' costs and improve efficiencies in the supply chain. We also provide services such as field safety supervision, in-house and field repair and predictive maintenance. We offer a wide range of industrial MRO products, equipment and services through a complete continuum of customized and efficient MRO solutions.

DXP Service Centers are stocked and staffed with knowledgeable sales associates and backed by a centralized customer service team of experienced industry professionals. Our Service Centers’ products and services are distributed from 123 service centers and 7 distribution centers.

DXP Service Centers provide a wide range of MRO products in the rotating equipment, bearing, power transmission, hose, fluid power, metal working, industrial supply and safety product categories. We currently serve as a first-tier distributor of more than 1,000,000 items of which more than 60,000 are stock keeping units (“SKUs”) for use primarily by customers engaged in the oil and gas, food and beverage, petrochemical, transportation and other general industrial industries. Other industries served by our Service Centers include mining, construction, chemical, municipal, agriculture and pulp and paper.



Virtually all of the segment's long-lived assets are located in the U.S. and virtually all sales are recognized in the U.S.

At December 31, 2011, the Service Centers segment had approximately 1,295 full-time employees.

## Supply Chain Services Segment

DXP's Supply Chain Services segment manages the supply-chain of its customers from across a variety of industries. Our mission is to help our customers become more competitive by reducing their indirect material costs and order cycle time by increasing productivity and by creating enterprise-wide inventory and procurement visibility and control.

DXP has developed assessment tools and master plan templates aimed at taking cost out of supply chain processes, streamlining operations and boosting productivity. This multi-faceted approach allows us to manage the entire channel for maximum efficiency and optimal control, which ultimately provides our customers with a low-cost solution.

DXP takes a consultative approach to determine the strengths and opportunities for improvement within a customer's indirect supply chain. This assessment determines if and how we can best streamline operations, drive value within the procurement process, and increase control in storeroom management.

Decades of supply chain inventory management experience and comprehensive research, as well as a thorough understanding of our customer's business and industry have allowed us to design standardized programs that are flexible enough to be fully adaptable to address our customers' unique supply chain challenges. These standardized programs include:

- SmartAgreement, a planned, pro-active procurement solution for MRO categories serviced by local DXP Service Centers.
  - SmartBuy, DXP's on-site or centralized MRO procurement solution.
  - SmartSourceSM, DXP's on-site procurement and storeroom management by DXP personnel.
    - SmartStore, DXP's customized e-Catalog solution.
- SmartVend, DXP's industrial dispensing solution. It allows for inventory-level optimization, user accountability and item usage reduction by 20-40% and
- SmartServ, DXP's integrated service pump solution. It provides a more efficient way to manage the entire life cycle of pumping systems and rotating equipment.

DXP's SmartSolutions programs help customers to cut product costs, improve supply chain efficiencies and obtain expert technical support. DXP represents manufacturers of up to 90% of all the maintenance, repair and operating products of our customers. Unlike many other distributors who buy products from second-tier sources, DXP takes customers to the source of the products they need.

The Supply Chain Services segment operates supply chain installations in 55 of our customers' facilities.

All of the segment's long-lived assets are located in the U. S. and all of 2011 sales were recognized in the U.S.

At December 31, 2011, the Supply Chain Services segment had approximately 276 full-time employees.

### Innovative Pumping Solutions Segment

DXP's Innovative Pumping Solutions® segment provides fabrication and technical design to meet the capital equipment needs of our global customer base.

DXP's engineering staff can design a complete custom pump package to meet the customers' project specifications. Drafting programs such as Solidworks and AutoCAD allow our engineering team to verify the design and layout of packages with our customers prior to the start of fabrication. FEA programs such as Cosmos Professional are used to design the package to meet all normal and future loads and forces. This process helps maximize the pump packages' life and minimizes any impact to the environment.

With over 100 years of fabrication experience, DXP has acquired the technical expertise to ensure that our pumps and pump packages are built to meet the highest standards. DXP utilizes manufacturer authorized equipment and certified personnel. Pump packages require MRO and OEM equipment such as pumps, motors, valves, and consumable products, such as welding supplies. DXP leverages its MRO inventories and breadth of authorized products to lower the total cost and maintain the quality of the pump package.

DXP's fabrication facilities provide convenient technical support and pump services. They have been designed with state of the art equipment to provide the technical services our customers require:

- Certified structural welding
  - Certified pipe welding
  - Custom skid assembly
    - Custom coatings
- Hydrostatic pressure testing
- Mechanical string testing
- ABS/DNV certification

Examples of our innovative pump packages include:

- Diesel and electric driven firewater
  - Pipeline booster
  - Potable water packages
  - Pigging pump packages
    - LACT charge units
- Chemical injection pump packages wash down units
  - Seawater lift pumps
    - Jockey pumps
  - Condensate pump packages
    - Cooling water skids
- Seawater/produced water injection packages
- Variety of packages to meet API, ANSI and NFPA 20 specifications

The Innovative Pumping Solutions segment operates out of 8 facilities located in Texas, Arizona, Louisiana, Colorado and Nebraska.

All of the segment's long-lived assets are located in the U. S. and virtually all sales are recognized in the U.S.

At December 31, 2011, the Innovative Pumping Solutions segment had approximately 230 full-time employees.

## Products

Most industrial customers currently purchase their MRO supplies through local or national distribution companies that are focused on single or unique product categories. As a first-tier distributor, our network of service and distribution centers stock more than 60,000 stock keeping units and provide customers with access to more than 1,000,000 items. Given our breadth of product and the industrial distribution customers focus around key products categories such as bearings & power transmission, fluid handling and power, safety, metal working and industrial supplies, we have become customer driven experts in five key product categories. As such, our three business segments are supported by five key product categories including, rotating equipment, bearings & power transmission, industrial supplies, metal working and safety products & services. Each business segment tailors its inventory and leverages product

experts to meet the needs of its local customers.

Key product categories that we offer include:

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- **Rotating Equipment.** Our rotating equipment products include a full line of centrifugal pumps for transfer and process service applications, such as petrochemicals, refining and crude oil production; rotary gear pumps for low-to medium pressure service applications, such as pumping lubricating oils and other viscous liquids; plunger and piston pumps for high-pressure service applications such as salt water injection and crude oil pipeline service; and air-operated diaphragm pumps. We also provide various pump accessories.
- **Bearings & Power Transmission.** Our bearing products include several types of mounted and unmounted bearings for a variety of applications. The power transmission products we distribute include speed reducers, flexible-coupling drives, chain drives, sprockets, gears, conveyors, clutches, brakes and hoses.
- **Industrial Supplies.** We offer a broad range of industrial supplies, such as abrasives, tapes and adhesive products, coatings and lubricants, fasteners, hand tools, janitorial products, pneumatic tools, welding supplies and welding equipment.
- **Metal Working.** Our metal working products include a broad range of cutting tools, abrasives, coolants, gauges, industrial tools and machine shop supplies.
- **Safety Products & Services.** We provide safety services including safety supervision, training, monitoring, equipment rental and consulting. Our safety products and services include safety supervision, medic services, safety audits, instrument repair and calibration, training, monitoring, equipment rental and consulting. Additionally, we sell safety products including eye and face protection, first aid, hand protection, hazardous material handling, instrumentation and respiratory protection products.

We acquire our products through numerous original equipment manufacturers, or OEMs. We are authorized to distribute certain manufacturers' products in only specific geographic areas. All of our distribution authorizations are subject to cancellation by the manufacturer upon one-year notice or less. For the last three fiscal years, no manufacturer provided products that accounted for 10% or more of our revenues. We believe that alternative sources of supply could be obtained in a timely manner if any distribution authorization were canceled. Accordingly, we do not believe that the loss of any one distribution authorization would have a material adverse effect on our business, financial condition or results of operations.

#### Recent Acquisitions

A key component of our growth strategy includes effecting acquisitions of businesses with complementary or desirable product lines, locations or customers. Since 2004, we have completed 17 acquisitions across our three business segments. Below is a summary of recent acquisitions since the end of 2006.

On May 4, 2007, DXP completed the acquisition of the business of Delta Process Equipment. DXP paid \$10 million in cash for this business. DXP acquired this business to diversify DXP's customer base in the municipal, wastewater and downstream industrial pump markets. The purchase price was funded by utilizing available capacity under DXP's credit facility.

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 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 \$2.0 million in future payments which were contingent upon future earnings.

On January 31, 2008, DXP completed the acquisition of the business of Rocky Mtn. Supply. DXP acquired this business to expand DXP's presence in the Colorado area. DXP paid \$3.9 million in cash and \$0.7 million in seller notes.

On August 28, 2008, DXP completed the acquisition of PFI, LLC ("PFI"). DXP acquired this business to strengthen DXP's expertise in the distribution of fasteners. DXP paid \$66.4 million in cash for this business.

On December 1, 2008, DXP completed the acquisition of the business of Falcon Pump. DXP acquired this business to strengthen DXP's pump offering in the Rocky Mountain area. DXP paid \$3.1 million in cash, \$0.8 million in seller notes and \$0.2 million in cash based upon earnings after the acquisition date.

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. DXP completed this acquisition to expand its pump business in the Western U.S.

On November 30, 2010, DXP acquired substantially all of the assets of D&F Distributors, Inc. ("D&F"). The purchase price of \$13.4 million consisted of approximately \$7.4 million paid in cash, approximately \$2.9 million in the form of promissory notes bearing interest at a rate of 5%, and approximately \$3.1 million in the form of 155,393 shares of DXP common stock. The cash portion of the purchase price was funded by borrowings under DXP's existing credit facility. DXP completed this acquisition to expand its pump business in Indiana, Kentucky, Tennessee and Ohio.

On October 10, 2011, DXP acquired substantially all of the assets of Kenneth Crosby ("KC"). DXP acquired this business to expand DXP's geographic presence in the eastern U.S. and strengthen DXP's metal working and supply chain services offerings. DXP paid approximately \$16 million for KC, which was borrowed under our existing credit facility.

On December 30, 2011, DXP acquired substantially all of the assets of C.W. Rod Tool Company ("CW Rod"). DXP acquired this business to strengthen DXP's metal working offering in Texas and Louisiana. DXP paid approximately \$1.1 million of DXP's common stock (35,714 shares) and approximately \$42 million in cash for CW Rod, which was borrowed during 2011 and 2012 under our recently expanded credit facility.

## Competition

Our business is highly competitive. In the Service Centers segment we compete with a variety of industrial supply distributors, many of which may have greater financial and other resources than we do. Many of our competitors are small enterprises selling to customers in a limited geographic area. We also compete with catalog distributors, large warehouse stores and, to a lesser extent, manufacturers. While many of our competitors offer traditional distribution of some of the product groupings that we offer, we are not aware of any major competitor that offers on a non-catalog basis a range of products and services as broad as our offering. Further, while certain catalog distributors provide product offerings as broad as ours, these competitors do not offer the product application, technical design and after-the-sale services that we provide. In the Supply Chain Services segment we compete with larger distributors that provide integrated supply programs and outsourcing services, some of which might be able to supply their products in



a more efficient and cost-effective manner than we can provide. In the Innovative Pumping Solutions segment we compete against a variety of manufacturers, distributors and fabricators, many of which may have greater financial and other resources than we do. We generally compete on service and price in all of our segments.

## Insurance

We maintain liability and other insurance that we believe to be customary and generally consistent with industry practice. We retain a portion of the risk for medical claims, general liability, worker's compensation and property losses. The various deductibles of our insurance policies generally do not exceed \$200,000 per occurrence. There are also certain risks for which we do not maintain insurance. There can be no assurance that such insurance will be adequate for the risks involved, that coverage limits will not be exceeded or that such insurance will apply to all liabilities. The occurrence of an adverse claim in excess of the coverage limits that we maintain could have a material adverse effect on our financial condition and results of operations. The premiums for insurance have increased significantly over the past three years. This trend could continue. Additionally, we are partially self-insured for our group health plan, worker's compensation, auto liability and general liability insurance. The cost of claims for the group health plan has increased over the past three years. This trend is expected to continue.

## Government Regulation and Environmental Matters

We are subject to various laws and regulations relating to our business and operations, and various health and safety regulations as established by the Occupational Safety and Health Administration.

Certain of our operations are subject to federal, state and local laws and regulations controlling the discharge of materials into or otherwise relating to the protection of the environment. Although we believe that we have adequate procedures to comply with applicable discharge and other environmental laws, the risks of accidental contamination or injury from the discharge of controlled or hazardous materials and chemicals cannot be eliminated completely. In the event of such a discharge, we could be held liable for any damages that result, and any such liability could have a material adverse effect on us. We are not currently aware of any situation or condition that we believe is likely to have a material adverse effect on our results of operations or financial condition.

## Employees

At December 31, 2011, DXP had approximately 2,093 full-time employees. We believe that our relationship with our employees is good.

## Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended (the "Exchange Act"), are available free of charge through our Internet website ([www.dxpe.com](http://www.dxpe.com)) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

## ITEM 1A. Risk Factors

The following is a discussion of significant risk factors relevant to DXP's business that could adversely affect its business, financial condition or results of operations.

The trading price of our common stock may be volatile.

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this and other periodic reports, and other factors beyond our control, such as fluctuations in

the valuation of companies perceived by investors to be comparable to us. Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political, and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock. In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

Our future results will be impacted by our ability to implement our internal growth strategy.

Our future results will depend in part on our success in implementing our internal growth strategy, which includes expanding our existing geographic areas, selling additional products to existing customers and adding new customers. Our ability to implement this strategy will depend on our success in selling more products and services to existing customers, acquiring new customers, hiring qualified sales persons, and marketing integrated forms of supply management such as those being pursued by us through our SmartSourceSM program. Although we intend to increase sales and product offerings to existing customers, there can be no assurance that we will be successful in these efforts.

#### Risks Associated With Acquisition Strategy

Our future results will depend in part on our ability to successfully implement our acquisition strategy. We may not be able to consummate acquisitions at rates similar to the past, which could adversely impact our growth rate and our stock price. This strategy includes taking advantage of a consolidation trend in the industry and effecting acquisitions of businesses with complementary or desirable product lines, strategic distribution locations, attractive customer bases or manufacturer relationships. Promising acquisitions are difficult to identify and complete for a number of reasons, including high valuations, competition among prospective buyers, the need for regulatory (including antitrust) approvals and the availability of affordable funding in the capital markets. In addition, competition for acquisitions in our business areas is significant and may result in higher purchase prices. Changes in accounting or regulatory requirements or instability in the credit markets could also adversely impact our ability to consummate acquisitions. In addition, acquisitions involve a number of special risks, including possible adverse effects on our operating results, diversion of management's attention, failure to retain key personnel of the acquired business, risks associated with unanticipated events or liabilities, and expenses associated with obsolete inventory of an acquired business, some or all of which could have a material adverse effect on our business, financial condition and results of operations. Our ability to grow at or above our historic rates depends in part upon our ability to identify and successfully acquire and integrate companies and businesses at appropriate prices and realize anticipated cost savings.

#### Risks Related to Acquisition Financing

We may need to finance acquisitions by using shares of Common Stock for a portion or all of the consideration to be paid. In the event that the Common Stock does not maintain a sufficient market value, or potential acquisition candidates are otherwise unwilling to accept Common Stock as part of the consideration for the sale of their businesses, we may be required to use more of our cash resources, if available, to maintain our acquisition program. These cash resources may include borrowings under our credit agreement or equity or debt financings. Our current credit agreement with our bank lenders contains certain restrictions that could adversely affect our ability to implement and finance potential acquisitions. Such restrictions include a provision prohibiting us from merging or consolidating with, or acquiring all or a substantial part of the properties or capital stock of, any other entity without the prior written consent of the lenders. There can be no assurance that we will be able to obtain the lender's consent to any of our proposed acquisitions. If we do not have sufficient cash resources, our growth could be limited unless we are able to obtain additional capital through debt or equity financings.

#### Ability to Comply with Financial Covenants of Credit Facility

Our credit facility requires the Company to comply with certain specified covenants, restrictions, financial ratios and other financial and operating tests. The Company's ability to comply with any of the foregoing restrictions will depend on its future performance, which will be subject to prevailing economic conditions and other factors, including factors beyond the Company's control. A failure to comply with any of these obligations could result in an event of default

under the credit facility, which could permit acceleration of the Company's indebtedness under the credit facility. The Company from time to time has been unable to comply with some of the financial covenants contained in the credit facility (relating to, among other things, the maintenance of prescribed financial ratios) and has, when necessary, obtained waivers or amendments to the covenants from its lenders. Although the Company expects to be able to comply with the covenants, including the financial covenants, of the credit facility, there can be no assurance that in the future the Company will be able to do so or, if is not able to do so, that its lenders will be willing to waive such compliance or further amend such covenants.

Goodwill and intangible assets recorded as a result of our acquisitions could become impaired.

Goodwill represents the difference between the purchase price of acquired companies and the related fair values of net assets acquired. We test goodwill for impairment annually and whenever events or changes in circumstances indicate that impairment may have occurred. As of December 31, 2011, our combined goodwill and intangible assets amounted to \$145.0 million, net of accumulated amortization. To the extent we do not generate sufficient cash flows to recover the net amount of any investments in goodwill and other intangible assets recorded, the investment could be considered impaired and subject to write-off. We expect to record additional goodwill and other intangible assets as a result of future acquisitions we may complete. Future amortization of such other intangible assets or impairments, if any, of goodwill or intangible assets would adversely affect our results of operations in any given period.

Our business has substantial competition that could adversely affect our results.

Our business is highly competitive. We compete with a variety of industrial supply distributors, some of which may have greater financial and other resources than us. Although many of our traditional distribution competitors are small enterprises selling to customers in a limited geographic area, we also compete with larger distributors that provide integrated supply programs such as those offered through outsourcing services similar to those that are offered by our SCS segment. Some of these large distributors may be able to supply their products in a more timely and cost-efficient manner than us. Our competitors include catalog suppliers, large warehouse stores and, to a lesser extent, certain manufacturers. Competitive pressures could adversely affect DXP's sales and profitability.

The loss of or the failure to attract and retain key personnel could adversely impact our results of operations.

We will continue to be dependent to a significant extent upon the efforts and ability of David R. Little, our Chairman of the Board, President and Chief Executive Officer. The loss of the services of Mr. Little or any other executive officer of our Company could have a material adverse effect on our financial condition and results of operations. In addition, our ability to grow successfully will be dependent upon our ability to attract and retain qualified management and technical and operational personnel. The failure to attract and retain such persons could materially adversely affect our financial condition and results of operations.

The loss of any key supplier could adversely affect DXP's sales and profitability.

We have distribution rights for certain product lines and depend on these distribution rights for a substantial portion of our business. Many of these distribution rights are pursuant to contracts that are subject to cancellation upon little or no prior notice. Although we believe that we could obtain alternate distribution rights in the event of such a cancellation, the termination or limitation by any key supplier of its relationship with the Company could result in a temporary disruption of our business and, in turn, could adversely affect our results of operations and financial condition.

A slowdown in the economy could negatively impact DXP's sales growth.

Economic and industry trends affect DXP's business. Demand for our products is subject to economic trends affecting our customers and the industries in which they compete in particular. Many of these industries, such as the oil and gas industry, are subject to volatility while others, such as the petrochemical industry, are cyclical and materially affected by changes in the economy. As a result, demand for our products could be adversely impacted by changes in the markets of our customers.

Interruptions in the proper functioning of our information systems could disrupt operations and cause increases in costs and/or decreases in revenues.

The proper functioning of DXP's information systems is critical to the successful operation of our business. Although DXP's information systems are protected through physical and software safeguards and remote processing capabilities exist, our information systems are still vulnerable to natural disasters, power losses, telecommunication failures and other problems. If critical information systems fail or are otherwise unavailable, DXP's ability to procure products to sell, process and ship customer orders, identify business opportunities, maintain proper levels of inventories, collect accounts receivable and pay accounts payable and expenses could be adversely affected.

#### ITEM 1B. Unresolved Staff Comments

None.

#### ITEM 2. Properties

We own our headquarters facility in Houston, Texas, which has approximately 48,000 square feet of office space. The Service Centers segment owns or leases 123 facilities located in Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virginia, Wyoming and Sonora, Mexico. The Supply Chain Services segment operates supply chain installations in 55 of our customers' facilities in Alabama, Arkansas, Arizona, California, Florida, Georgia, Illinois, Indiana, Louisiana, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and Wisconsin. The Innovative Pumping Solutions segment operates out of 8 facilities located in Texas, Louisiana, Colorado, Arizona and Nebraska. Our owned facilities range from 5,000 square feet to 65,000 square feet in size. We lease facilities for terms generally ranging from one to fifteen years. The leased facilities range from 1,500 square feet to 170,000 square feet in size. The leases provide for periodic specified rental payments and certain leases are renewable at our option. We believe that our facilities are suitable and adequate for the needs of our existing business. We believe that if the leases for any of our facilities were not renewed, other suitable facilities could be leased with no material adverse effect on our business, financial condition or results of operations. One of the facilities owned by us is pledged to secure our indebtedness.

#### ITEM 3. Legal Proceedings

On July 22, 2004, DXP and Ameron International Corporation, DXP's vendor of fiberglass reinforced pipe, were sued in the Twenty-Fourth Judicial District Court, Parish of Jefferson, State of Louisiana by BP America Production Company regarding the failure of Bondstrand PSX JFC pipe, a recently introduced type of fiberglass reinforced pipe which had been installed on four energy production platforms. BP American Production Company alleges negligence, breach of contract, breach of warranty and that damages exceed \$20 million. DXP believes the failures were not caused by work performed by DXP. We intend to vigorously defend these claims. Our insurance carrier has agreed, under a reservation of rights to deny coverage, to provide a defense against these claims. The maximum amount of our insurance coverage, if any, is \$6 million. Under certain circumstances, our insurance may not cover this claim. DXP currently believes the claim is without merit and the possibility of the claim having a material adverse effect on our business, financial condition, cash flows or results of operations is remote.

From time to time, the Company is a party to various legal proceedings arising in the ordinary course of its business. The Company believes that the outcome of any of these various proceedings will not have a material adverse effect on its business, cash flows, financial condition or results of operations.

#### ITEM 4. Mine Safety Disclosures

Not applicable.





## PART II

## ITEM 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on The NASDAQ Global Market under the stock symbol "DXPE".

The following table sets forth on a per share basis the high and low sales prices for our common stock as reported by NASDAQ for the periods indicated.

|                | High     | Low      |
|----------------|----------|----------|
| 2010           |          |          |
| First Quarter  | \$ 13.59 | \$ 10.75 |
| Second Quarter | \$ 17.98 | \$ 11.25 |
| Third Quarter  | \$ 21.59 | \$ 14.84 |
| Fourth Quarter | \$ 24.76 | \$ 17.61 |
| 2011           |          |          |
| First Quarter  | \$ 24.99 | \$ 18.43 |
| Second Quarter | \$ 26.71 | \$ 22.01 |
| Third Quarter  | \$ 27.81 | \$ 17.89 |
| Fourth Quarter | \$ 33.58 | \$ 17.01 |

On March 5, 2012, we had approximately 499 holders of record for outstanding shares of our common stock. This number does not include shareholders for whom shares are held in "nominee" or "street name".

We anticipate that future earnings will be retained to finance the continuing development of our business. In addition, our bank credit facility prohibits us from declaring or paying any cash dividends or other distributions on our capital stock, except for the monthly \$0.50 per share dividend on our Series B convertible preferred stock, which amounts to \$90,000 in the aggregate per year. Accordingly, we do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of any future dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, the success of our business activities, regulatory and capital requirements, lenders, and general financial and business conditions.

#### Stock Performance

The following performance graph compares the performance of DXP Common Stock to the NASDAQ Industrial Index and the NASDAQ Composite (US). The graph assumes that the value of the investment in DXP Common Stock and in each index was \$100 at December 31, 2006 and that all dividends were reinvested.

Investors are cautioned against drawing conclusions from the data contained in the graph as past results are not necessarily indicative of future performance.

Equity Compensation Table

The following table provides information regarding shares covered by the Company's equity compensation plans as of December 31, 2011:

| Plan category  | Number of Shares to be issued on exercise of outstanding options | Weighted average exercise price of outstanding options | Non-vested restricted shares outstanding | Weighted average grant price | Number of securities remaining available for future issuance under equity compensation plans |
|--|--|--|--|------------------------------|--|
| Equity compensation plans approved by shareholders     | N/A  | N/A  | 228,592                                  | \$21.10                      | 48,784(1)  |
| Equity compensation plans not approved by shareholders | N/A  | N/A  | N/A                                      | N/A                          | N/A  |
| Total  | N/A  | N/A  | 228,592                                  | \$21.10                      | 48,784(1)  |

(1) Represents shares of common stock authorized for issuance under the 2005 Restricted Stock Plan.

## Repurchases of Common Stock

The following table provides information about the Company's purchases of shares of the Company's common stock during the fourth quarter of 2011.

|  | Total Number<br>of Shares<br>Purchased(1) | Average<br>Price Paid<br>per Share | Total Number<br>of<br>shares<br>Purchased as<br>part of<br>Publicly<br>announced<br>Plans or<br>Programs | Maximum<br>Number<br>of Shares that<br>may<br>yet be<br>Purchased<br>under the<br>Plans or<br>Programs |
|--|---|------------------------------------|--|--|
| October 1, 2011<br>through October 31,<br>2011 | 15,171                                    | \$17.90                            | -  | -  |
| Totals   | 15,171                                    | \$17.90                            | -  | 200,000(2)   |

(1) Shares were purchased in non-open market transactions.

(2) On October 26, 2011, the Board of Directors authorized DXP from time to time to purchase up to 200,000 shares of DXP's common stock over 24 months. DXP publicly announced the authorization that day. Purchases may be made in open market or in privately negotiated transactions. DXP had not purchased any shares under this authorization as of December 31, 2011.

## ITEM 6. Selected Financial Data

The selected historical consolidated financial data set forth below for each of the years in the five-year period ended December 31, 2011 has been derived from our audited consolidated financial statements. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this Report.

|  | Years Ended December 31, |                     |            |            |            |
|--|--------------------------|---------------------|------------|------------|------------|
|  | 2007<br>Restated(1)      | 2008<br>Restated(1) | 2009(2)    | 2010       | 2011       |
| (in thousands, except per share amounts) |                          |                     |            |            |            |
| Consolidated Statement of Earnings Data: |                          |                     |            |            |            |
| Sales                                    | \$ 444,547               | \$ 736,883          | \$ 583,226 | \$ 656,202 | \$ 807,005 |
| Gross Profit                             | 125,692                  | 206,988             | 151,414    | 188,395    | 231,836    |
| Operating income (loss)                  | 31,892                   | 48,191              | (49,332)   | 37,091     | 55,485     |
| Income (loss) before income taxes        | 28,897                   | 42,284              | (54,482)   | 32,132     | 51,995     |
| Net income (loss)                        | 17,347                   | 25,887              | (42,412)   | 19,381     | 31,437     |
| Per share amounts                        |                          |                     |            |            |            |
| Basic earnings (loss) per common share   | \$ 1.46                  | \$ 1.99             | \$ (3.24)  | \$ 1.40    | \$ 2.19    |

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|   |         |         |           |         |         |
|---|---------|---------|-----------|---------|---------|
| Common shares<br>outstanding                          | 11,811  | 12,945  | 13,117    | 13,821  | 14,301  |
| Diluted earnings (loss) per<br>share                  | \$ 1.35 | \$ 1.87 | \$ (3.24) | \$ 1.32 | \$ 2.08 |
| Common and common<br>equivalent<br>shares outstanding | 12,860  | 13,869  | 13,117    | 14,821  | 15,141  |

(1) Basic and diluted earnings per share amounts have been restated due to adoption in the first quarter of 2009 of authoritative guidance which requires awards of unvested restricted stock to be treated as if outstanding in the calculation of earnings per share. On September 30, 2008, DXP paid a two for one common stock dividend. DXP's financial statements have been restated to reflect the effect of this common stock dividend on all periods presented.

(2) The goodwill and other intangibles impairment charge and the Precision inventory impairment charge in 2009 reduced operating income by \$66.8 million and increased basic and diluted loss per share by \$3.82.



| Consolidated Balance Sheet<br>Data | As of December 31, |            |            |            |            |
|------------------------------------|--------------------|------------|------------|------------|------------|
|                                    | 2007               | 2008       | 2009       | 2010       | 2011       |
| Total assets                       | \$ 288,170         | \$ 397,856 | \$ 270,927 | \$ 320,624 | \$ 405,338 |
| Long-term debt obligations         | 101,989            | 154,591    | 102,916    | 103,621    | 114,205    |
| Shareholders' equity               | 102,713            | 130,188    | 90,213     | 124,120    | 156,675    |

## ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and related notes contained elsewhere in this Report.

### General Overview

Our products and services are marketed in at least 42 states in the United States and Sonora, Mexico to over 50,000 customers that are engaged in a variety of industries, many of which may be countercyclical to each other. Demand for our products generally is subject to changes in the United States and global economy and economic trends affecting our customers and the industries in which they compete in particular. Certain of these industries, such as the oil and gas industry, are subject to volatility while others, such as the petrochemical industry and the construction industry, are cyclical and materially affected by changes in the United States and global economy. As a result, we may experience changes in demand within particular markets, segments and product categories as changes occur in our customers' respective markets.

During 2007, the general economy and the oil and gas exploration and production business continued to be positive. During 2007, our headcount increased by 112% primarily as a result of three acquisitions. Sales by the three businesses acquired in 2007 accounted for \$92.3 million of the \$164.7 million sales increase. The 2007 sales increase, excluding sales of businesses acquired in 2006 and 2007, resulted from a broad based increase in sales by our service centers, innovative pumping solution locations and supply chain locations. Excluding sales of businesses acquired in 2006 and 2007, on a same store sales basis, 2007 sales increased by 15.7%.

During 2008, the general economy weakened. However, the oil and gas exploration and production business continued to be positive during the first half of 2008, before declining during the second half of 2008. During 2008 our headcount increased by 18% primarily as a result of three acquisitions. Sales by the three businesses acquired in 2008 accounted for \$33.4 million of 2008 sales. Sales by the three businesses acquired in 2007 accounted for \$200.4 million of 2008 sales, on a same store sales basis. Excluding sales of businesses acquired in 2007 and 2008, on a same store sales basis, 2008 sales increased 13.2%. This increase resulted from a broad-based increase in sales by our service centers, innovative pumping solution locations and supply chain locations.

During 2009, the general economy and the oil and gas exploration and production business declined significantly. During 2009, our headcount decreased by approximately 10% as a result of actions taken to reduce operating costs. Sales for 2009 declined by 21% from 2008. Sales by businesses acquired during 2008, on a same store sales basis, accounted for \$36.1 million of 2010 sales. Excluding these sales by acquired businesses, sales declined by 26% from 2008. The 2009 sales decline is primarily due to a broad-based decline in the sales of pumps, bearings, safety products and industrial supplies in connection with a broad-based decline in the U.S. economy. This economic decline led to the impairment of our goodwill and other intangibles. During the fourth quarter of 2009 the Company recognized an impairment charge of \$53.0 million for goodwill and other intangibles and an impairment charge of \$13.8 million to reduce the valuation of inventory acquired in the acquisition of Precision. The impairment charges did not result in any cash expenditures, did not adversely affect compliance with covenants under our credit

facility, and did not affect our cash position or cash flows from operating activities.

During 2010, the general economy and the oil and gas exploration and production business improved. Our employee headcount increased by approximately 7% as a result of two acquisitions. Excluding the employees at the two acquired businesses headcount declined by approximately 1%, primarily as a result of consolidating back office functions. Sales by Quadna, acquired April 1, 2010 and D&F, acquired December 1, 2010, accounted for \$43.6 million of 2010 sales. Excluding Quadna and D&F sales, sales for 2010 increased 5.0%.



During 2011, the general economy and the oil and gas exploration and production business continued to improve. Our employee headcount increased by 18% primarily as a result of two acquisitions and hiring additional personnel to support increased sales. Sales for the year ended December 31, 2011 increased \$150.8 million, or 23.0%, to approximately \$807.0 million from \$656.2 million in 2010. Sales by KC, acquired October 10, 2011, accounted for \$11.9 million of 2011 sales. Sales by businesses acquired in 2010, on a same store sales basis, accounted for \$35.6 million of 2011 sales. Excluding 2011 sales by businesses acquired in 2010 and 2011, on a same store sales basis, sales increased 15.8% from 2010. The majority of the 2011 sales increase came from a broad-based increase in sales of pumps, bearings, safety products and industrial supplies to customers engaged in oilfield service, oil and gas exploration and production, mining, manufacturing and petrochemical processing.

Our sales growth strategy in recent years has focused on internal growth and acquisitions. Key elements of our sales strategy include leveraging existing customer relationships by cross-selling new products, expanding product offerings to new and existing customers, and increasing business-to-business solutions using system agreements and supply chain solutions for our integrated supply customers. We will continue to review opportunities to grow through the acquisition of distributors and other businesses that would expand our geographic breadth and/or add additional products and services. Our results will depend on our success in executing our internal growth strategy and, to the extent we complete any acquisitions, our ability to integrate such acquisitions effectively.

Our strategies to increase productivity include consolidated purchasing programs, centralizing product distribution centers, and customer service and inside sales functions, converting selected locations from full warehouse and customer service operations to service centers, and using information technology to increase employee productivity.

#### Results of Operations

|   | Years Ended December 31,                                |        |          |       |          |       |
|---|---|--------|----------|-------|----------|-------|
|   | 2009(1)   | %      | 2010     | %     | 2011     | %     |
|   | (in millions, except percentages and per share amounts) |        |          |       |          |       |
| Sales                                     | \$ 583.2  | 100.0  | \$ 656.2 | 100.0 | \$ 807.0 | 100.0 |
| Cost of sales                             | 431.8   | 74.0   | 467.8    | 71.3  | 575.2    | 71.3  |
| Gross profit                              | 151.4   | 26.0   | 188.4    | 28.7  | 231.8    | 28.7  |
| Selling, general & administrative expense | 147.8   | 25.3   | 151.3    | 23.1  | 176.3    | 21.9  |
| Goodwill and other intangibles impairment | 53.0  | 9.1    | -        | -     | -        | -     |
| Operating income (loss)                   | (49.3)  | (8.5)  | 37.1     | 5.7   | 55.5     | 6.9   |
| Interest expense                          | 5.2   | 0.9    | 5.2      | 0.8   | 3.5      | 0.4   |
| Other income                              | (0.1)   | -      | (0.2)    | -     | -        | -     |
| Income (loss) before income taxes         | (54.5)  | (9.3)  | 32.1     | 4.9   | 52.0     | 6.4   |
| Provision (benefit) for income taxes      | (12.1)  | (2.1)  | 12.7     | 2.0   | 20.6     | 2.5   |
| Net income (loss)                         | \$(42.4)  | (7.3%) | \$ 19.4  | 3.0   | \$ 31.4  | 3.9   |
| Per share                                 |   |        |          |       |          |       |
| Basic earnings (loss) per share           | \$(3.24)  |        | \$ 1.40  |       | \$ 2.19  |       |
| Diluted earnings (loss) per share         | \$(3.24)  |        | \$ 1.32  |       | \$ 2.08  |       |

(1) The goodwill and other intangibles impairment charge and the Precision inventory impairment charge in 2009 reduced operating income by \$66.8 million and increased basic

and diluted loss per share by \$3.82.

DXP is organized into three business segments: Service Centers, Supply Chain Services (“SCS”) and Innovative Pumping Solutions (“IPS”). The Service Centers are engaged in providing maintenance, repair and operating products, equipment and services, including logistics capabilities, to industrial customers. The Service Centers provide a wide range of MRO products in the rotating equipment, bearing, power transmission equipment, fastener, cutting tools, industrial supplies and safety product categories. The IPS segment fabricates and assembles custom-made engineered pump packages. The SCS segment manages all or part of customer’s supply chain, including inventory.

Year Ended December 31, 2011 compared to Year Ended December 31, 2010

**SALES.** Sales for the year ended December 31, 2011 increased \$150.8 million, or 23.0%, to approximately \$807.0 million from \$656.2 million in 2010. Sales by KC, acquired October 10, 2011, accounted for \$11.9 million of 2011 sales. Sales by businesses acquired in 2010, on a same store sales basis, accounted for \$35.6 million of 2011 sales. Excluding 2011 sales by businesses acquired in 2010 and 2011, on a same store sales basis, sales increased 15.8% from 2010.

**GROSS PROFIT.** Gross profit as a percentage of sales was 28.7% for 2011 and 2010.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for 2011 increased by approximately \$25.0 million when compared to 2010. A portion of the increase relates to \$9.6 million of selling, general and administrative expense for businesses acquired in 2010 and 2011, on a same store sales basis. Excluding the expenses of businesses acquired in 2010 and 2011, on a same store sales basis, the increase primarily resulted from increased salaries, incentive compensation, employee benefits and travel expenses compared to 2010. As a percentage of revenue, the 2011 expense decreased to 21.9% from 23.1% for 2010.

**OPERATING INCOME.** Operating income for 2011 increased 49.6% compared to 2010. This increase is the result of gross profit increasing 23.1% while selling, general and administrative expense increased only 16.6%.

**INTEREST EXPENSE.** Interest expense for 2011 decreased by 32.5% from 2010. This decrease primarily resulted from lower average interest rates combined with a reduction in the average amount of debt outstanding compared to 2010. On July 25, 2011 we amended our credit facility. This amendment significantly decreased the interest rates and commitment fees applicable at various leverage ratios from levels in effect before July 25, 2011.

**INCOME TAXES.** Our provision for income taxes differed from the U. S. statutory rate of 35% due to state income taxes and non-deductible expenses. Our effective tax rate for 2011 of 39.6% was consistent with the 39.7% rate for 2010.

**SERVICE CENTERS SEGMENT.** Sales for the Service Centers segment increased \$107.5 million, or 23.7%. Excluding \$9.1 million of first quarter 2011 Quadna Service Centers segment sales, first eleven months of 2011 sales by D&F of \$23.2 million and \$5.9 million of fourth quarter 2011 KC Service Centers segment sales, Service Center segment sales for 2011 increased 15.3% from 2010, on a same store sales basis. This sales increase is primarily due to improvement in the oil and gas and manufacturing portions of the U.S. economy. Operating income for the Service Centers segment increased 27.6%, primarily as a result of the 23.7% increase in sales combined with an increase in gross profit as a percentage of sales.

**SUPPLY CHAIN SERVICES SEGMENT.** Sales for the SCS segment increased by \$18.0 million, or 14.2%, for 2011 when compared to 2010. Excluding KC SCS segment sales of \$5.9 million, SCS segment sales for 2011 increased 9.5% from 2010, on a same store sales basis. Operating income for the SCS segment increased 18.7% primarily as a result of the 14.2% increase in sales for this segment.

**INNOVATIVE PUMPING SOLUTIONS SEGMENT.** Sales for the IPS segment increased by \$25.3 million, or 32.8% for 2011 when compared to 2010. Excluding first quarter 2011 Quadna IPS sales of \$3.3 million, IPS sales for 2011 increased 28.5% from 2010, on a same store sales basis. The sales increase resulted from the increase in capital spending by our oil and gas and mining related customers. Operating income for the IPS segment increased 63.7% as a result of the 32.8% increase in sales combined with relatively consistent selling, general and administrative expenses.

Year Ended December 31, 2010 compared to Year Ended December 31, 2009

SALES. Sales for the year ended December 31, 2010 increased \$73.0 million, or 12.5%, to approximately \$656.2 million from \$583.2 million in 2009. Sales by Quadna, acquired April 1, 2010 and D&F, acquired December 1, 2010, accounted for \$43.6 million of 2010 sales. Excluding Quadna and D&F sales, sales for 2010 increased 5.0%, on a same store sales basis.

**GROSS PROFIT.** Gross profit as a percentage of sales increased to approximately 28.7% for 2010 from 26.0% for 2009. This increase is primarily the result of the \$13.8 million charge in the fourth quarter of 2009 to reduce the value of inventory acquired with the acquisition of Precision on September 10, 2007. Excluding this \$13.8 million charge, gross profit as a percentage of sales for 2009 would have been 28.3%. The increase in gross profit as a percentage of sales in 2010 from this 28.3% for 2009 is primarily the result of improvement in the U.S. economy.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSE.** Selling, general and administrative expense for 2010 increased by approximately \$3.5 million, or 2.4%, when compared to 2009. Selling, general and administrative expense for Quadna and D&F for 2010 was \$7.6 million. As a percentage of revenue, the 2010 expense decreased to 23.1%, from 25.3% for 2009. This decrease is primarily the result of sales increasing 12.5% and expenses increasing only 2.4%.

**OPERATING INCOME.** Excluding the effect of the \$13.8 million inventory impairment charge and the \$53.0 million goodwill and other intangible impairment charges recorded in 2009, operating income for 2010 increased 112% compared to 2009.

**INTEREST EXPENSE.** Interest expense for 2010 decreased by 0.7% from 2009. 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. This increase in interest rates was offset by the effect of lower average debt outstanding during 2010 compared to 2009.

**INCOME TAXES.** Our provision for income taxes differed from the U. S. statutory rate of 35% due to state income taxes and non-deductible expenses. Our effective tax rate for 2010 of 39.7% increased from 22.2% for 2009. The 2009 tax rate was unusually low primarily as a result of the non-deductible goodwill and other intangibles impairment charge for PFI, LLC recorded in 2009.

**SERVICE CENTERS SEGMENT.** Sales for the Service Centers segment increased \$61.7 million, or 15.8%. Excluding Quadna and D&F Service Centers sales of \$26.2 million, Service Centers segment sales for 2010 increased 9.1% from 2009. This sales increase is primarily due to improvement in the industrial portion of the U.S. economy. Operating income for the Service Centers segment increased \$26.2 million. Excluding the effect of the \$12.8 million of inventory impairment charges recorded by the Service Centers segment during 2009, operating income for the Service Centers segment increased 35.9% as a result of the 15.8% increase in sales combined with the effect of cost reduction measures implemented during 2009 and 2010.

**SUPPLY CHAIN SERVICES SEGMENT.** Sales for the SCS segment decreased by \$9.8 million, or 7.2%, from 2009. The sales decrease by SCS resulted from sales to customers in 2009 which subsequently terminated supply agreements, exceeding sales to customers which had been added since 2009. Operating income for the SCS segment increased 28.3%. Excluding the \$1.0 million of inventory impairment charges recorded by the SCS segment during 2009, operating income for the SCS segment increased by 8.7%, primarily as a result of the reduced administrative costs for this segment.

**INNOVATIVE PUMPING SOLUTIONS SEGMENT.** Sales for the IPS segment increased by \$21.1 million, or 37.8%, for 2010 when compared to 2009. Excluding Quadna IPS sales of \$17.4 million for 2010, IPS sales increased 6.6% from 2009. The sales increase resulted from the improvement in the economy and the associated increase in capital spending by our customers. Operating income for the IPS segment increased 37.5% as a result of the 37.8% increase in sales.



## Pro Forma Results

The pro forma unaudited results of operations for the Company on a consolidated basis for the years ended December 31, 2009 and 2010, assuming the acquisitions of businesses completed in 2010 were consummated as of January 1, 2009 follows:

|                         | Years Ended<br>December 31,                   |            |
|-------------------------|---|------------|
|                         | 2009  | 2010       |
|                         | (Unaudited)                                   |            |
|                         | In Thousands,<br>except for per share<br>data |            |
| Net sales               | \$653,175                                     | \$ 689,675 |
| Net<br>(loss)<br>income | \$(39,967)                                    | \$ 20,843  |
| Per share<br>data       |   |            |
| Basic                   | \$(3.04)                                      | \$ 1.50    |
| Earnings                |   |            |
| Diluted                 | \$(3.04)                                      | \$ 1.42    |
| Earnings                |   |            |

The pro forma unaudited results of operations for the Company on a consolidated basis for the years ended December 31, 2010 and 2011, assuming the acquisitions of businesses completed in 2011 were consummated as of January 1, 2010 follows:

|                | Years Ended<br>December 31,                   |            |
|----------------|---|------------|
|                | 2010  | 2011       |
|                | (Unaudited)                                   |            |
|                | In Thousands,<br>except for per share<br>data |            |
| Net sales      | \$ 778,267                                    | \$ 903,240 |
| Net income     | \$ 22,898                                     | \$ 35,511  |
| Per share data |   |            |
| Basic          | \$ 1.65                                       | \$ 2.48    |
| Earnings       |   |            |
| Diluted        | \$ 1.56                                       | \$ 2.35    |
| Earnings       |   |            |

## Liquidity and Capital Resources

## General Overview

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

We generated approximately \$25.8 million of cash in operating activities in 2011 as compared to generating \$23.9 million in 2010. This change between the two years was primarily attributable to the \$12.1 million increase in net income, partially offset by the \$21.5 million increase in accounts receivable in 2011 compared to a \$14.5 million increase in accounts receivable in 2010.

During 2011 we paid \$18.4 million of cash for two businesses acquired during 2011 compared to paying \$18.2 million of cash related to the purchase of two businesses during 2010 and \$0.2 million related to businesses acquired before 2009. The \$18.4 million of cash paid for acquisitions in 2011 excludes \$36.7 million in outstanding checks at December 31, 2011 related to the acquisition of CW Rod and approximately \$2.2 million expected to be paid due to a working capital adjustment.



We purchased approximately \$4.1 million of capital assets during 2011 compared to \$1.2 million for 2010. Capital expenditures during 2011 and 2010 were related primarily to computer equipment, computer software, production equipment, inventory handling equipment, safety rental equipment and building improvements. Capital expenditures for 2012 are expected to be in the range of the 2009, 2010 and 2011 amounts.

At December 31, 2011, our total long-term debt, including the current portion, was \$114.9 million compared to total capitalization (total long-term debt plus shareholders' equity) of \$271.6 million. Approximately \$110.8 million of this outstanding debt bears interest at various floating rates. Therefore, as an example, a 200 basis point increase in interest rates would increase our annual interest expense by approximately \$2.2 million.

Our normal trade terms for our customers require payment within 30 days of invoice date. In response to competition and customer demands we will offer extended terms to selected customers with good credit history. Customers that are financially strong tend to request extended terms more often than customers that are not financially strong. Many of our customers, including companies listed in the Fortune 500, do not pay us within stated terms for a variety of reasons, including a general business philosophy to pay vendors as late as possible.

During 2011, the amount available to be borrowed under our credit facility increased from \$50.0 million at December 31, 2010, to \$78.2 million at December 31, 2011. The increase in availability is primarily the result of the effect of increased accounts receivable and inventories. Our total long-term debt increased \$0.3 million during 2011. Management believes that the liquidity of our balance sheet at December 31, 2011, provides us with the ability to meet our working capital needs, scheduled principal payments, capital expenditures and Series B convertible preferred stock dividend payments during 2012.

#### Credit Facility

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

On December 31, 2011, the LIBOR based rate of the Facility was LIBOR plus 1.5%, the prime based rate of the Facility was prime plus 0.0% and the commitment fee was 0.2%. At December 31, 2011, \$110.5 million was borrowed under the Facility at a weighted average interest rate of approximately 1.78% under the LIBOR options and

\$0.3 million was borrowed at 3.25% under the prime option. 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 December 31, 2011, we had \$78.2 million available for borrowing under the Facility.

The Facility's principal financial covenants include:

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Fixed Charge Coverage Ratio –The Facility requires that the Fixed Charge Coverage Ratio for the 12 month period ending on the last day of each quarter be not less than 1.50 to 1.0 with “Fixed Charge Coverage Ratio” defined as the ratio of (a) EBITDA for the 12 months ending on such date minus cash taxes and Capital Expenditures for such period (excluding acquisitions) to (b) the aggregate of interest expense paid in cash, scheduled principal payments in respect of long-term debt and current portion of capital leases for such 12-month period, determined in each case on a consolidated basis for DXP and its subsidiaries. At December 31, 2011, the Company's Fixed Charge Coverage Ratio was 14.2.

Leverage Ratio – The Facility requires that the Company’s Leverage Ratio, determined at the end of each fiscal quarter, not exceed 4.0 to 1.0 as of the last day of each quarter. The Leverage Ratio is defined as the outstanding Indebtedness divided by EBITDA for the 12 months then ended. At December 31, 2011, the Company’s Leverage Ratio was 1.49 to 1.00. Indebtedness is defined under the Facility for financial covenant purposes as: (a) all obligations of DXP for borrowed money including but not limited to senior bank debt, senior notes and subordinated debt; (b) capital leases; (c) issued and outstanding letters of credit; and (d) contingent obligations for funded indebtedness.

The following is the computation of the Leverage Ratio as of December 31, 2011 (in thousands, except for ratios):

|   |                   |
|---|-------------------|
| For the Year ended<br>December 31, 2011 | Leverage<br>Ratio |
|---|-------------------|

|                     |          |
|---------------------|----------|
| Income before taxes | \$51,995 |
|---------------------|----------|

|                  |       |
|------------------|-------|
| Interest expense | 3,518 |
|------------------|-------|

|                               |        |
|-------------------------------|--------|
| Depreciation and amortization | 10,082 |
|-------------------------------|--------|

|                            |       |
|----------------------------|-------|
| Stock compensation expense | 1,256 |
|----------------------------|-------|

|                       |        |
|-----------------------|--------|
| Pro forma acquisition | 10,871 |
|-----------------------|--------|

|                                      |       |
|--------------------------------------|-------|
| EBITDA                               |       |
| Reduction of closed location accrual | (123) |

|                    |        |
|--------------------|--------|
| (A) Defined EBITDA | 77,599 |
|--------------------|--------|

|                               |  |
|-------------------------------|--|
| As of<br>December 31,<br>2011 |  |
|-------------------------------|--|

|                      |         |
|----------------------|---------|
| Total long-term debt | 114,899 |
|----------------------|---------|

|                   |     |
|-------------------|-----|
| Letters of credit | 951 |
|-------------------|-----|

outstanding  
(B) Defined \$115,850  
indebtedness  
L e v e r a g e      1.49  
Ratio (B)/(A)

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.

## Performance Metrics

|                                     | December 31, 2011 | December 31, 2010 | Increase (Decrease) |
|-------------------------------------|-------------------|-------------------|---------------------|
| Days of sales outstanding (in days) | 58.6              | 57.5              | 1.1                 |
| Inventory turns                     | 7.1               | 6.2               | 0.9                 |

Results for businesses acquired during each year were annualized to compute these performance metrics.

Accounts receivable days of sales outstanding were 58.6 at December 31, 2011 compared to 57.5 days at December 31, 2010. The increase resulted primarily from a change in customer mix which resulted in slower collection of accounts receivable. Annualized inventory turns were 7.1 times at December 31, 2011 compared to 6.2 times at December 31, 2010. The increase in inventory turns primarily resulted from the improvement in the U. S. economy.

## Funding Commitments

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

## Share Repurchases

During 2011, DXP repurchased 65,171 shares of DXP's common stock in non-open market transactions at an average price per share of \$22.18.

On October 26, 2011, the Board of Directors authorized DXP from time to time to purchase up to 200,000 shares of DXP's common stock over 24 months. DXP publicly announced the authorization that day. Purchases may be made in open market or in privately negotiated transactions. DXP had not purchased any shares under this authorization as of December 31, 2011.

## Borrowings

|                                      | December 31, 2011 | December 31, 2010 | Increase (Decrease) |
|--------------------------------------|-------------------|-------------------|---------------------|
|                                      | (in thousands)    |                   |                     |
| Current portion of long-term debt    | \$ 694            | \$ 10,930         | \$(10,236)          |
| Long-term debt, less current portion | 114,205           | 103,621           | 10,584              |

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|                      |            |            |             |
|----------------------|------------|------------|-------------|
| Total long-term debt | \$ 114,899 | \$ 114,551 | \$348       |
| Amount available (1) | \$ 78,201  | \$ 50,020  | \$28,181(2) |

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

(2) The \$28.2 million increase in the amount available is primarily a result of the effect of increased accounts receivable and inventories on the loan covenant ratios.

## Contractual Obligations

The impact that our contractual obligations as of December 31, 2011 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

|  | Payments Due by Period |                     |              |              |                      |
|--|------------------------|---------------------|--------------|--------------|----------------------|
|  | Total                  | Less than<br>1 Year | 1-3<br>Years | 3-5<br>Years | More than<br>5 Years |
| Long-term debt, including<br>current portion (1) | \$114,899              | \$ 694              | \$ 2,796     | \$111,409    | \$ -                 |
| Operating lease obligations                      | 44,710                 | 11,191              | 17,972       | 8,754        | 6,793                |
| Estimated interest<br>payments (2)               | 553                    | 320                 | 218          | 15           | -                    |
| Total  | \$160,162              | \$12,205            | \$20,986     | \$120,178    | \$ 6,793             |

(1) Amounts represent the expected cash payments of our long-term debt and do not include any fair value adjustment.

(2) Assumes interest rates in effect at December 31, 2011. Assumes debt is paid on maturity date and not replaced. Does not include interest on the revolving line of credit as borrowings under the Facility fluctuate. The amounts of interest incurred for borrowings under the revolving lines of credit were approximately \$4,700,000, \$4,900,000, and \$3,000,000 for 2009, 2010 and 2011, respectively. Management anticipates an increased level of interest payments on the Facility in 2012 as a result of expected increased borrowings to fund expected acquisitions.

## Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPE's"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2011, we were not involved in any unconsolidated SPE transactions, nor did we have any other off-balance sheet arrangements.

## Indemnification

In the ordinary course of business, DXP enters into contractual arrangements under which DXP may agree to indemnify customers from any losses incurred relating to the services we perform. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnities have been immaterial.

## 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, valuation of intangibles, impairment analysis, income taxes, self-insured liability claims and self-insured medical claims. Actual results could differ from those estimates. Management periodically re-evaluates these estimates as

events and circumstances change. Together with the effects of the matters discussed above, these factors may significantly impact the Company's results of operations from period-to-period.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's subjective or complex judgments. These policies have been discussed with the Audit Committee of the Board of Directors of DXP. Below is a discussion of what we believe are our critical accounting policies. Also, see Note 1 of the Notes to the Consolidated Financial Statements.



## Revenue Recognition

For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues using the percentage of completion method. Under this method, revenues are recognized as costs are incurred and include estimated profits calculated on the basis of the relationship between costs incurred and total estimated costs at completion. If at any time expected costs exceed the value of the contract, the loss is recognized immediately. Approximately \$9.8 million of revenues were recognized on contracts in process as of December 31, 2011. The typical time span of these contracts is approximately one to two years.

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

## Allowance for Doubtful Accounts

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

## Inventory

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

## Self-insured Insurance and Medical Claims

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

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

The accrual for these claims at December 31, 2011 and 2010 was approximately \$2.4 million and \$1.8 million, respectively.

## Impairment of Long-Lived Assets and Goodwill

Goodwill represents a significant portion of our total assets. We review goodwill for impairment annually during our fourth quarter, or more frequently if certain impairment indicators arise under the provisions of authoritative guidance. We review goodwill at the reporting level unit, which is one level below an operating segment. In prior years we compared the carrying value of the net assets of each reporting unit to the net present value of estimated discounted anticipated cash flows of each reporting unit, discounted using a weighted average cost of capital rate. If the carrying value exceeded the net present value of estimated discounted anticipated cash flows, an impairment indicator existed and an estimate of the impairment loss was calculated. The fair value calculation included management views and multiple assumptions and estimates, including the projected cash flows and discount rates applied. Estimated cash

flows were primarily based on projected revenues, operating costs and capital expenditures and were discounted based on comparable industry average rates for weighted average cost of capital. Changes in these assumptions and estimates could have resulted in goodwill impairment that could have materially adversely impacted our financial position or results of operations. Assets, liabilities, deferred taxes and goodwill for each reporting unit were determined using the balance sheets maintained for each reporting unit.

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

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

Goodwill of \$101.8 million was primarily recorded in connection with the 17 acquisitions completed since 2004. Approximately \$16.0 million of goodwill is included in our Innovative Pumping Solutions segment. Approximately \$82.9 million of goodwill is included in the two reporting units for our Service Centers segment which are DXP and PFI. Approximately \$2.9 million of goodwill is included in our Supply Chain Services segment.

During 2011 the U.S. economy improved and oil prices increased, which led to improvements in our sales, margins and cash flows. Our sales and profitability improved throughout the year. We considered the impact of these changes in the economic and business climate as we performed our annual impairment assessments of goodwill as of December 31, 2011. In the fourth quarter of 2011, in conjunction with our December 31, 2011 goodwill assessment, we adopted new accounting guidance that allows an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount and if a quantitative assessment should be performed. We performed a qualitative analysis and concluded it is more likely than not that the fair value of each reporting unit is not less than its carrying value and therefore, did not perform a quantitative analysis. Accordingly, the annual impairment assessment at December 31, 2011 indicated there is no impairment of goodwill. Qualitative factors considered during our assessment include the capital markets environment, U.S. economic conditions, industrial distribution industry competition and trends, oil and gas exploration and production industry trends, changes in our results of operations, the magnitude of the excess of fair value over the carrying amount of each reporting unit as determined in prior years' quantitative testing and other factors. We believe the fair value of our reporting units substantially exceeds the carrying value of our reporting units.

Long-lived assets, including property, plant and equipment and amortizable intangible assets comprise a significant portion of our total assets. We evaluate the carrying value of long-lived assets when impairment indicators are present or when circumstances indicate that impairment may exist under authoritative guidance. When events or changes in circumstances indicate that a long-lived asset carrying amount may not be recoverable, a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Depending on the circumstances, this could be at a reporting unit or segment level. Estimates of future cash flows are generally used to test the recoverability of a long-lived asset (asset group), unless market information is available that would more clearly indicate the fair value of an asset or asset group. To the extent estimates of future cash flows are utilized, only the future cash flows (cash inflows less associated cash outflows) that are directly associated with, and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group) are utilized. Those estimates shall exclude interest charges that will be recognized as an expense when incurred. These impairment tests are heavily influenced by assumptions and estimates that are subject to change as additional information becomes available. We concluded DXP did not have an impairment of long-lived assets during 2011.



### Purchase Accounting

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

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

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

### Income Taxes

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

### Stock-Based Compensation

No future grants will be made under the Company's existing stock option plans. The Company currently uses restricted stock for share-based compensation programs. Compensation expense recognized for share-based compensation programs in the years ended December 31, 2009, 2010 and 2011 was \$1,555,000, \$973,000 and \$1,256,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$2,423,000 and \$4,051,000, respectively, at December 31, 2010 and 2011. As of December 31, 2011, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 29.6 months.

### Recent Accounting Pronouncements

See Note 2 of the Notes to the Consolidated Financial Statements for discussion of recent accounting pronouncements.

### Inflation

We do not believe the effects of inflation have any material adverse effect on our results of operations or financial condition. We attempt to minimize inflationary trends by passing manufacturer price increases on to the customer whenever practicable.

### ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

Our market risk results primarily from volatility in interest rates. Our exposure to interest rate risk relates primarily to our debt portfolio. Using floating interest rate debt outstanding at December 31, 2011, a 100 basis point increase in interest rates would increase our annual interest expense by approximately \$1.1 million.

The table below provides information about the Company's market sensitive financial instruments and constitutes a forward-looking statement.

| Principal Amount By Expected Maturity<br>(in thousands, except percentages) |       |         |       |       |            |            |            | Fair<br>Value |
|---|-------|---------|-------|-------|------------|------------|------------|---------------|
|   | 2012  | 2013    | 2014  | 2015  | 2016       | Thereafter | Total      |               |
| Fixed Rate  |       |         |       |       |            |            |            |               |
| Long-term<br>Debt   | \$694 | \$2,216 | \$580 | \$580 | -          | -          | \$4,070    | \$4,070       |
| Average   |       |         |       |       |            |            |            |               |
| Interest Rate   | 5.2%  | 5.92%   | 5.00% | 5.00% | -          | -          |            |               |
| Floating Rate   |       |         |       |       |            |            |            |               |
| Long-term<br>Debt   | -     | -       | -     | -     | -\$110,829 | -          | -\$110,829 | \$110,829     |
| Average   |       |         |       |       |            |            |            |               |
| Interest Rate<br>(1)  |       |         |       |       | 1.79%      |            |            |               |
| Total   |       |         |       |       |            |            |            |               |
| Maturities  | \$694 | \$2,216 | \$580 | \$580 | \$110,829  | -          | -\$114,899 | \$114,899     |

(1) Assumes floating interest rates in effect at December 31, 2011.

## ITEM 8. Financial Statements and Supplementary Data

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Report Of Independent Registered Public Accounting Firm on Financial Statements

To the Board of Directors and Shareholders of  
DXP Enterprises, Inc., and Subsidiaries  
Houston, Texas

We have audited the accompanying consolidated balance sheets of DXP Enterprises, Inc. and Subsidiaries as of December 31, 2010 and 2011, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of DXP Enterprises, Inc., and Subsidiaries at December 31, 2010 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We were engaged to audit, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of DXP Enterprises, Inc. and Subsidiaries internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our report dated March 9, 2012, expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

Hein & Associates LLP  
Houston, Texas

March 9, 2012

Report of Independent Registered Public Accounting Firm  
on Internal Control over Financial Reporting

To the Board of Directors and Shareholders of  
DXP Enterprises, Inc.  
Houston, Texas

We were engaged to audit DXP Enterprises, Inc.'s (the "Company") internal control over financial reporting based upon criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of DXP Enterprises, Inc. as of December 31, 2010 and 2011, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three year period ended December 31, 2011. Our report thereon dated March 9, 2012 expressed an unqualified opinion.

Hein & Associates LLP  
Houston, Texas

March 9, 2012





MANAGEMENT'S REPORT  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company has assessed the effectiveness of its internal control over financial reporting as of December 31, 2011 based on criteria established by Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO Framework”). The Company’s management is responsible for establishing and maintaining adequate internal controls over financial reporting. The Company’s independent registered public accountants that audited the Company’s financial statements as of December 31, 2011, have issued an attestation report on the Company’s internal control over financial reporting, which appears on page 31.

Internal control over financial reporting is a process designed by, or under the supervision of, a company’s principal executive and principal financial officers, and effected by the Company’s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

The Company’s assessment of the effectiveness of its internal control over financial reporting included testing and evaluating the design and operating effectiveness of its internal controls with the participation of its principal executive and principal financial officers. In management’s opinion, the Company has maintained effective internal control over financial reporting as of December 31, 2011, based on criteria established in the COSO Framework.

/s/ David R. Little  
David R. Little  
Chairman of the Board and  
and  
Chief Executive Officer

/s/ Mac McConnell

Mac McConnell  
Senior Vice President/Finance  
  
Chief Financial Officer

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

|   | December 31, |            |
|---|--------------|------------|
|   | 2010         | 2011       |
| <b>ASSETS</b>   |              |            |
| Current assets:   |              |            |
| Cash  | \$ 770       | \$ 1,507   |
| Trade accounts receivable, net of allowances for doubtful accounts of \$3,540 in 2010 and \$6,202 in 2011   | 99,781       | 137,024    |
| Inventories, net  | 75,887       | 93,901     |
| Prepaid expenses and other current assets   | 2,550        | 2,230      |
| Federal income tax receivable   | 402          | -          |
| Deferred income taxes   | 5,919        | 4,539      |
| Total current assets  | 185,309      | 239,201    |
| Property and equipment, net   | 14,917       | 16,911     |
| Goodwill  | 84,942       | 101,764    |
| Other intangibles, net of accumulated amortization of \$19,603 in 2010 and \$26,175 in 2011   | 32,236       | 43,194     |
| Non-current deferred income taxes   | 2,289        | 1,588      |
| Other assets  | 931          | 2,680      |
| Total assets  | \$ 320,624   | \$ 405,338 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |              |            |
| Current liabilities:  |              |            |
| Current portion of long-term debt   | \$ 10,930    | \$ 694     |
| Trade accounts payable  | 55,019       | 62,123     |
| Outstanding checks related to acquisition   | -            | 36,697     |
| Accrued wages and benefits  | 11,826       | 12,713     |
| Customer advances   | 5,824        | 3,767      |
| Federal income taxes payable  | -            | 2,409      |
| Other accrued liabilities   | 9,284        | 16,055     |
| Total current liabilities   | 92,883       | 134,458    |
| Long-term debt, less current portion  | 103,621      | 114,205    |
| Commitments and contingencies (Note 10)   |              |            |
| Shareholders' equity:   |              |            |
| Series A preferred stock, 1/10th vote per share; \$1.00 par value; liquidation preference of \$100 per share (\$112 at December 31, 2011); 1,000,000 shares authorized; 1,122 shares issued and outstanding | 1            | 1          |
|   |              | 15         |

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|  |            |            |
|--|------------|------------|
| Series B convertible preferred stock,<br>1/10th vote per share; \$1.00 par value;<br>\$100 stated value; liquidation preference<br>of \$100 per share (\$1,500 at December<br>31, 2011); 1,000,000 shares<br>authorized; 15,000 shares issued and<br>outstanding | 15         |            |
| Common stock, \$0.01 par value,<br>100,000,000 shares<br>authorized; 14,079,608 and 14,118,220<br>shares issued and<br>outstanding, respectively.  | 140        | 141        |
| Paid-in capital  | 72,616     | 75,204     |
| Retained earnings  | 51,348     | 82,695     |
| Accumulated other comprehensive<br>income  | -          | 64         |
| Treasury stock, at cost (65,171 shares)  | -          | (1,445)    |
| Total shareholders' equity   | 124,120    | 156,675    |
| Total liabilities and shareholders'<br>equity  | \$ 320,624 | \$ 405,338 |
| The accompanying notes are an integral part of these consolidated financial statements.  |            |            |

**DXP ENTERPRISES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In Thousands, Except Per Share Amounts)

|   | Years Ended December 31, |            |            |
|---|--------------------------|------------|------------|
|   | 2009                     | 2010       | 2011       |
| Sales   | \$ 583,226               | \$ 656,202 | \$ 807,005 |
| Cost of sales   | 431,812                  | 467,807    | 575,169    |
| Gross profit  | 151,414                  | 188,395    | 231,836    |
| Selling, general and administrative expense           | 147,795                  | 151,304    | 176,351    |
| Goodwill and other intangibles impairment             | 52,951                   | -          | -          |
| Operating income (loss)                               | (49,332)                 | 37,091     | 55,485     |
| Other income  | 95                       | 249        | 28         |
| Interest expense                                      | (5,245)                  | (5,208)    | (3,518)    |
| Income (loss) before provision for income taxes       | (54,482)                 | 32,132     | 51,995     |
| Provision (benefit) for income taxes                  | (12,070)                 | 12,751     | 20,558     |
| Net income (loss)                                     | (42,412)                 | 19,381     | 31,437     |
| Preferred stock dividend                              | (90)                     | (90)       | (90)       |
| Net income (loss) attributable to common shareholders | \$ (42,502)              | \$ 19,291  | \$ 31,347  |
| Net income (loss)                                     | \$ (42,412)              | \$ 19,381  | \$ 31,437  |
| Gain from interest rate swap, net of income taxes     | 695                      | 26         | -          |
| Gain on long-term investment, net of income taxes     | -                        | -          | 64         |
| Comprehensive income (loss)                           | \$ (41,717)              | \$ 19,407  | \$ 31,501  |
| Per share and share amounts                           |                          |            |            |
| Basic earnings (loss) per common share                | \$ (3.24)                | \$ 1.40    | \$ 2.19    |
| Common shares outstanding                             | 13,117                   | 13,821     | 14,301     |
| Diluted earnings (loss) per share                     | \$ (3.24)                | \$ 1.32    | \$ 2.08    |
| Common and common equivalent shares                   | 13,117                   | 14,821     | 15,141     |

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



DXP ENTERPRISES, INC.  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
Years Ended December 31, 2009, 2010 and 2011  
(in Thousands, Except Share Amounts)

|  | Series A<br>Preferred<br>Stock | Series B<br>Preferred<br>Stock | Common<br>Stock | Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total     |
|--|--------------------------------|--------------------------------|-----------------|--------------------|----------------------|-------------------|--|-----------|
| <b>BALANCES</b>  |                                |                                |                 |                    |                      |                   |  |           |
| <b>AT DECEMBER</b>   |                                |                                |                 |                    |                      |                   |  |           |
| 31, 2008   | \$ 1                           | \$ 15                          | \$ 128          | \$56,206           | \$74,559             | -                 | \$(721)  | \$130,188 |
| Dividends paid   | -                              | -                              | -               | -                  | (90)                 | -                 | -  | (90)      |
| Compensation<br>expense for<br>restricted stock  | -                              | -                              | -               | 1,555              | -                    | -                 | -  | 1,555     |
| Net gain on interest<br>rate swap<br>for comprehensive<br>income   | -                              | -                              | -               | -                  | -                    | -                 | 695  | 695       |
| Exercise of stock<br>options and vesting<br>of<br>restricted stock<br>for 71,897 shares<br>of common stock | -                              | -                              | 1               | 276                | -                    | -                 | -  | 277       |
| Net loss   | -                              | -                              | -               | -                  | (42,412)             | -                 | -  | (42,412)  |
| <b>BALANCES</b>  |                                |                                |                 |                    |                      |                   |  |           |
| <b>AT DECEMBER</b>   |                                |                                |                 |                    |                      |                   |  |           |
| 31, 2009   | \$ 1                           | \$ 15                          | \$ 129          | \$58,037           | \$32,057             | -                 | \$(26)   | \$90,213  |
| Dividends paid   | -                              | -                              | -               | -                  | (90)                 | -                 | -  | (90)      |
| Compensation<br>expense for<br>restricted stock  | -                              | -                              | -               | 973                | -                    | -                 | -  | 973       |
| Net gain on interest<br>rate swap<br>for comprehensive<br>income   | -                              | -                              | -               | -                  | -                    | -                 | 26   | 26        |
| Issuance of 498,730<br>shares in<br>connection with<br>acquisitions  | -                              | -                              | 5               | 7,061              | -                    | -                 | -  | 7,066     |
| Issuance of 493,791<br>shares upon<br>conversion of<br>notes to<br>common stock                            | -                              | -                              | 5               | 6,206              | -                    | -                 | -  | 6,211     |

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|  |    |   |    |     |        |        |           |          |           |         |           |
|--|----|---|----|-----|--------|--------|-----------|----------|-----------|---------|-----------|
| Exercise of stock options and vesting of restricted stock for 149,886 shares of common stock | -  | - | 1  | 339 | -      | -      | -         | 340      |           |         |           |
| Net income   | -  | - | -  | -   | 19,381 | -      | -         | 19,381   |           |         |           |
| <b>BALANCES</b>  |    |   |    |     |        |        |           |          |           |         |           |
| <b>AT DECEMBER</b>   |    |   |    |     |        |        |           |          |           |         |           |
| 31, 2010   | \$ | 1 | \$ | 15  | \$     | 140    | \$72,616  | \$51,348 | -         | -       | \$124,120 |
| Dividends paid   | -  | - | -  | -   | -      | (90)   | -         | -        | -         | (90)    |           |
| Compensation expense for restricted stock  | -  | - | -  | -   | 1,256  | -      | -         | -        | -         | 1,256   |           |
| Net gain on long-term investment for comprehensive income                                    | -  | - | -  | -   | -      | -      | -         | -        | \$64      | 64      |           |
| Issuance of 35,714 shares in connection with acquisitions                                    | -  | - | -  | -   | 1,143  | -      | -         | -        | -         | 1,143   |           |
| Vesting of restricted stock for 68,069 shares of common stock                                | -  | - | -  | 1   | 189    | -      | -         | -        | -         | 190     |           |
| Acquisition of 65,171 shares of common stock   | -  | - | -  | -   | -      | -      | \$(1,445) | -        | -         | (1,445) |           |
| Net income   | -  | - | -  | -   | -      | 31,437 | -         | -        | -         | 31,437  |           |
| <b>BALANCES</b>  |    |   |    |     |        |        |           |          |           |         |           |
| <b>AT DECEMBER</b>   |    |   |    |     |        |        |           |          |           |         |           |
| 31, 2011   | \$ | 1 | \$ | 15  | \$     | 141    | \$75,204  | \$82,695 | \$(1,445) | \$64    | \$156,675 |

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



**DXP ENTERPRISES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In Thousands)

|   | Years Ended December 31 |           |           |
|---|-------------------------|-----------|-----------|
|   | 2009                    | 2010      | 2011      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                         |           |           |
| Net income (loss)   | \$ (42,412)             | \$ 19,381 | \$ 31,437 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities – net of acquisitions |                         |           |           |
| Goodwill and other intangible impairment  | 52,951                  | -         | -         |
| Precision inventory impairment  | 13,800                  | -         | -         |
| Depreciation  | 4,260                   | 3,744     | 3,510     |
| Amortization  | 7,216                   | 5,824     | 6,572     |
| Deferred income taxes   | (16,678)                | 2,914     | 2,081     |
| Stock-based compensation expense  | 1,555                   | 973       | 1,256     |
| Tax benefit related to exercise of stock options and vesting of restricted stock                              | (266)                   | (215)     | (198)     |
| 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   | 24,125                  | (14,528)  | (21,548)  |
| Inventories   | 32,716                  | 2,028     | (4,258)   |
| Prepaid expenses and other assets   | (1,665)                 | 1,165     | (2,617)   |
| Accounts payable and accrued expenses   | (24,027)                | 2,810     | 9,593     |
| Net cash provided by operating activities   | 51,575                  | 23,908    | 25,828    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                         |           |           |
| Purchase of property and equipment  | (1,593)                 | (1,184)   | (4,096)   |
| Purchase of businesses, net of cash acquired  | (491)                   | (18,394)  | (18,434)  |
| Proceeds from the sale of property and equipment  | 16                      | 1,428     | -         |
| Long-term investment  | -                       | -         | (1,572)   |
|   | (2,068)                 | (18,150)  | (24,102)  |

Net cash used in investing  
activities

| CASH FLOWS FROM<br>FINANCING ACTIVITIES:   |                 |                |                 |
|--|-----------------|----------------|-----------------|
| Proceeds from debt   | 133,716         | 141,216        | 224,307         |
| Principal payments on revolving line of credit, long-term debt and notes payable | (186,763)       | (148,798)      | (223,959)       |
| Dividends paid in cash   | (90)            | (90)           | (90)            |
| Proceeds from exercise of stock options  | 10              | 125            | -               |
| Purchase of treasury stock   | -               | -              | (1,445)         |
| Tax benefit related to exercise of stock options and vesting of restricted stock | 266             | 215            | 198             |
| Net cash used in financing activities  | (52,861)        | (7,332)        | (989)           |
| <b>INCREASE (DECREASE) IN CASH</b>   | <b>(3,354)</b>  | <b>(1,574)</b> | <b>737</b>      |
| <b>CASH AT BEGINNING OF YEAR</b>   | <b>5,698</b>    | <b>2,344</b>   | <b>770</b>      |
| <b>CASH AT END OF YEAR</b>   | <b>\$ 2,344</b> | <b>\$ 770</b>  | <b>\$ 1,507</b> |

SUPPLEMENTAL  
DISCLOSURES:

| Cash paid for --   |           |          |           |
|--------------------|-----------|----------|-----------|
| Interest           | \$ 5,338  | \$ 5,240 | \$ 3,490  |
| Income taxes       | \$ 15,053 | \$ 8,342 | \$ 14,190 |
| Income tax refunds | \$ 73     | \$ 250   | \$ 293    |

Purchase of businesses in 2010 excludes \$20 million of common stock, notes and convertible notes issued in connection with acquisitions 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. Purchases of businesses in 2011 excludes \$36.7 million in outstanding checks at December 31, 2011 and \$1.1 million of common stock issued in connection with an acquisition.

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

DXP ENTERPRISES INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

DXP Enterprises, Inc., a Texas corporation, was incorporated on July 26, 1996, to be the successor to SEPCO Industries, Inc., DXP Enterprises, Inc. and its subsidiaries (“DXP” or the “Company”) is engaged in the business of distributing maintenance, repair and operating products, equipment and service to industrial customers. The Company is organized into three business segments: Service Centers, Supply Chain Services (“SCS”) and Innovative Pumping Solutions (“IPS”). See Note 14 for discussion of the business segments.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform with the current year presentation.

Receivables and Credit Risk

Trade receivables consist primarily of uncollateralized customer obligations due under normal trade terms, which usually require payment within 30 days of the invoice date. However, these payment terms are extended in select cases and many customers do not pay within stated trade terms.

The Company has trade receivables from a diversified customer base located primarily in the Rocky Mountain, Northeastern, Midwestern, Southeastern and Southwestern regions of the United States. The Company believes no significant concentration of credit risk exists. The Company evaluates the creditworthiness of its customers' financial positions and monitors accounts on a regular basis, but generally does not require collateral. Provisions to the allowance for doubtful accounts are made monthly and adjustments are made periodically (as circumstances warrant) based upon management's best estimate of the collectability of all such accounts. The Company writes-off uncollectible trade accounts receivable when the accounts are determined to be uncollectible. No customer represents more than 10% of consolidated sales.

Inventories

Inventories consist principally of finished goods and are priced at lower of cost or market, cost being determined using the first-in, first-out (“FIFO”) method. Reserves are provided against inventories for estimated obsolescence based upon the aging of the inventories and market trends.

Property and Equipment

Assets are carried on the basis of cost. Provisions for depreciation are computed at rates considered to be sufficient to amortize the costs of assets over their expected useful lives. Depreciation of property and equipment is computed using the straight-line method. Maintenance and repairs of depreciable assets are charged against earnings as incurred. Additions and improvements are capitalized. When properties are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and gains or losses are credited or charged to earnings.

The principal estimated useful lives used in determining depreciation are as follows:

|                                   |   |
|-----------------------------------|---|
| Buildings                         | 20 – 39 years   |
| Building improvements             | 10 – 20 years   |
| Furniture, fixtures and equipment | 3 – 10 years  |
| Leasehold improvements<br>lease   | over the shorter of the estimated useful life or the term of the related<br>lease |

### Cash and Cash Equivalents

The Company's presentation of cash includes cash equivalents. Cash equivalents are defined as short-term investments with maturity dates of 90 days or less at time of purchase.

### Fair Value of Financial Instruments

A summary of the carrying and the fair value of financial instruments, excluding derivatives, at December 31, 2010 and 2011 is as follows (in thousands):

|   | 2010           |            | 2011           |            |
|---|----------------|------------|----------------|------------|
|   | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Cash                                      | \$770          | \$770      | \$1,507        | \$1,507    |
| Marketable securities                     | -              | -          | \$1,679        | \$1,679    |
| Long-term debt, including current portion | 114,551        | 114,551    | \$114,899      | \$114,899  |

The marketable securities are included in other assets on the consolidated balance sheet. The fair values were derived using quoted market prices. The carrying value of the long-term debt approximates fair value based upon the current rates and terms available to the Company for instruments with similar remaining maturities. The carrying amounts of accounts receivable and accounts payable approximate their fair values due to the short-term maturities of these instruments.

### Stock-Based Compensation

The Company uses restricted stock for share-based compensation programs. No future grants will be made under the Company's stock option plans. See Note 9 – Shareholders' Equity for additional information on stock-based compensation.

### Revenue Recognition

For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues using the percentage of completion method. Under this method, revenues are recognized as costs are incurred and include estimated profits calculated on the basis of the relationship between costs incurred and total estimated costs at completion. If at any time expected costs exceed the value of the contract, the loss is recognized immediately. Approximately \$9.8 million of revenues were recognized on contracts in process as of December 31, 2011. The typical time span of these contracts is approximately one to two years. At December 31, 2010 and 2011, \$2.8 million and \$7.4 million, respectively, of unbilled costs and estimated earnings are included in accounts receivable.

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.

The Company reserves for potential customer returns based upon the historical level of returns.

### Shipping and Handling Costs

The Company classifies shipping and handling charges billed to customers as sales. Shipping and handling charges paid to others are classified as a component of cost of sales.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company 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 the Company in the accompanying financial statements relate to the valuation of intangibles, impairment analysis, reserves for accounts receivable collectability, inventory valuations, income taxes and self-insured medical and liability claims. Actual results could differ from those estimates and such differences could be material.

### 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 their dependents. We accrue for the estimated outstanding balance of unpaid medical claims for our employees and their dependents. The accrual is adjusted monthly based on recent claims experience. The actual claims could deviate from recent claims experience and be materially different from the reserve.

The accrual for these claims at December 31, 2011 and 2010 was approximately \$2.4 million and \$1.8 million, respectively.

### Impairment of Long-Lived Assets and Goodwill

Goodwill represents a significant portion of our total assets. We review goodwill for impairment annually during our fourth quarter, or more frequently if certain impairment indicators arise under the provisions of authoritative guidance. We review goodwill at the reporting level unit, which is one level below an operating segment. In prior years we compared the carrying value of the net assets of each reporting unit to the net present value of estimated discounted anticipated cash flows of each reporting unit, discounted using a weighted average cost of capital rate. If the carrying value exceeded the net present value of estimated discounted anticipated cash flows, an impairment indicator existed and an estimate of the impairment loss was calculated. The fair value calculation included management views and multiple assumptions and estimates, including the projected cash flows and discount rates applied. Estimated cash flows were primarily based on projected revenues, operating costs and capital expenditures and were discounted based on comparable industry average rates for weighted average cost of capital. Changes in these assumptions and estimates could have resulted in goodwill impairment that could have materially adversely impacted our financial position or results of operations. Assets, liabilities, deferred taxes and goodwill for each reporting unit were determined using the balance sheets maintained for each reporting unit.

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

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

Goodwill of \$101.8 million was primarily recorded in connection with the 17 acquisitions completed since 2004. Approximately \$16.0 million of goodwill is included in our Innovative Pumping Solutions segment. Approximately \$82.9 million of goodwill is included in the two reporting units for our Service Centers segment which are DXP and PFI. Approximately \$2.9 million of goodwill is included in our Supply Chain Services segment.





During 2011 the U.S. economy improved and oil prices increased, which led to improvements in our sales, margins and cash flows. Our sales and profitability improved throughout the year. We considered the impact of these changes in the economic and business climate as we performed our annual impairment assessments of goodwill as of December 31, 2011. In the fourth quarter of 2011, in conjunction with our December 31, 2011 goodwill assessment, we adopted new accounting guidance that allows an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount and if a quantitative assessment should be performed. We performed a qualitative analysis and concluded it is more likely than not that the fair value of each reporting unit is not less than its carrying value and therefore, did not perform a quantitative analysis. Accordingly, the annual impairment assessment at December 31, 2011 indicated there is no impairment of goodwill. Qualitative factors considered during our assessment include the capital markets environment, U.S. economic conditions, industrial distribution industry competition and trends, oil and gas exploration and production industry trends, changes in our results of operations, the magnitude of the excess of fair value over the carrying amount of each reporting unit as determined in prior years' quantitative testing and other factors. We believe the fair value of our reporting units substantially exceeds the carrying value of our reporting units.

Long-lived assets, including property, plant and equipment and amortizable intangible assets comprise a significant portion of our total assets. We evaluate the carrying value of long-lived assets when impairment indicators are present or when circumstances indicate that impairment may exist under authoritative guidance. When events or changes in circumstances indicate that a long-lived asset carrying amount may not be recoverable, a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Depending on the circumstances, this could be at a reporting unit or segment level. Estimates of future cash flows are generally used to test the recoverability of a long-lived asset (asset group), unless market information is available that would more clearly indicate the fair value of an asset or asset group. To the extent estimates of future cash flows are utilized, only the future cash flows (cash inflows less associated cash outflows) that are directly associated with, and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group) are utilized. Those estimates shall exclude interest charges that will be recognized as an expense when incurred. These impairment tests are heavily influenced by assumptions and estimates that are subject to change as additional information becomes available. We concluded DXP did not have an impairment of long-lived assets during 2011.

During 2009 there were significant declines in U.S. and global economies and in oil and natural gas prices which led to declines in our sales, margins and cash flows. Our sales and profitability declined throughout the year particularly in the fourth quarter. We considered the impact of these significant adverse changes in the economic and business climate as we performed our annual impairment assessment of goodwill as of December 31, 2009. The estimated fair values of our reporting units were negatively impacted by significant reductions in estimated cash flows for the income approach. Our goodwill impairment analysis led us to conclude that there was a significant impairment of goodwill for the PFI reporting unit and a significant impairment of goodwill for the DXP reporting unit and, accordingly, we recorded a non-cash charge of \$40.7 million to our operating results for the year ended December 31, 2009, for the impairment of our goodwill. In connection with the our 2009 goodwill impairment test we concluded the 2009 decline in the business and economic climate and significant reductions in estimated cash flows for the income approach resulted in a full impairment of the value of customer relationships for the PFI reporting unit. This \$12.3 million expense is included in the "Goodwill and other intangible impairment" expense on the Consolidated Statements of Operations. The PFI reporting unit is part of the Service Centers segment.

#### Goodwill and Other Intangible Assets

The \$24.2 million increase in goodwill and the \$12.3 million increase in other intangibles acquired during 2010 results from recording the goodwill and other intangibles associated with the acquisitions of the assets of Quadna, Inc. ("Quadna") and D&F Distributors, Inc. ("D&F"). The \$0.2 million increase in goodwill for payment of earn out in 2010 relates to contingent purchase price for the 2008 acquisition of Falcon Pump. The \$15.8 million increase in goodwill

and the \$17.5 million increase in other intangibles acquired during 2011 results from recording the goodwill and other intangibles associated with the acquisitions of the assets of KC and CW Rod. The \$1.0 million increase in goodwill for payment of earn out in 2011 relates to contingent purchase price for the 2007 acquisition of Indian Fire and Safety. Other intangible assets are generally amortized on a straight line basis over the useful lives of the assets. Approximately \$82.9 million of goodwill and \$27.9 million of other intangible assets pertain to the Service Centers segment. Approximately \$16.0 million of goodwill and \$2.6 million of other intangible assets pertain to the IPS segment. Approximately \$2.9 million of goodwill and approximately \$12.7 million of other intangible assets pertain to the Supply Chain Services segment.

The changes in the carrying amount of goodwill and other intangibles for 2010 and 2011 are as follows (in thousands):

|                                 | Total     | Goodwill  | Other Intangibles |
|---------------------------------|-----------|-----------|-------------------|
| Balance as of December 31, 2009 | \$ 86,269 | \$ 60,542 | \$ 25,727         |
| Payment of earn out             | 200       | 200       | -                 |
| Acquired during the year        | 36,533    | 24,200    | 12,333            |
| Amortization                    | (5,824)   | -         | (5,824)           |
| Balance as of December 31, 2010 | \$117,178 | \$ 84,942 | \$ 32,236         |
| Payment of earn out             | 1,000     | 1,000     | -                 |
| Acquired during the year        | 33,352    | 15,822    | 17,530            |
| Amortization                    | (6,572)   | -         | (6,572)           |
| Balance as of December 31, 2011 | \$144,958 | \$101,764 | \$43,194          |

The changes in the carrying amount of goodwill by segment for 2010 and 2011 are as follows (in thousands):

|                                 | Total     | Service Centers | SCS     | IPS       |
|---------------------------------|-----------|-----------------|---------|-----------|
| Balance as of December 31, 2009 | \$ 60,542 | \$ 52,100       | -       | \$ 8,442  |
| Payment of earn out             | 200       | 200             | -       | -         |
| Acquired during the year        | 24,200    | 16,662          | -       | 7,538     |
| Balance as of December 31, 2010 | \$ 84,942 | \$ 68,962       | -       | \$ 15,980 |
| Payment of earn out             | 1,000     | 1,000           | -       | -         |
| Acquired during the year        | 15,822    | 12,897          | 2,925   | -         |
| Balance as of December 31, 2011 | \$101,764 | \$82,859        | \$2,925 | \$ 15,980 |

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

|                        | As of December 31, 2010 |                          | As of December 31, 2011 |                          |
|------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
|                        | Gross Carrying Amount   | Accumulated Amortization | Gross Carrying Amount   | Accumulated Amortization |
| Vendor agreements      | \$ 2,496                | \$ (831)                 | \$ 2,496                | \$ (956)                 |
| Customer relationships | 47,363                  | (17,237)                 | 64,262                  | (23,508)                 |
| Non-compete agreements | 1,980                   | (1,535)                  | 2,611                   | (1,711)                  |
| Total                  | \$ 51,839               | \$ (19,603)              | \$ 69,369               | \$ (26,175)              |

The estimated future annual amortization of intangible assets for each of the next five years follows (in thousands):

|            |          |
|------------|----------|
| 2012       | \$ 8,531 |
| 2013       | \$ 7,804 |
| 2014       | \$ 7,529 |
| 2015       | \$ 6,057 |
| 2016       | \$ 4,851 |
| Thereafter | \$ 8,422 |

The weighted average useful lives of acquired intangibles related to vendor agreements, customer relationships, and non-compete agreements are 20 years, 9.0 years and 4.3 years, respectively, at December 31, 2011. The weighted average useful life of amortizable intangible assets in total is 9.3 years at December 31, 2011.

Of the \$145.0 million net balance of goodwill and other intangibles at December 31, 2011, \$131.0 million is expected to be deductible for tax purposes.

### Purchase Accounting

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

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

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

### Income Taxes

The Company utilizes the asset and liability method of accounting for 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.

### Comprehensive Income

Comprehensive income includes net income, foreign currency translation adjustments, unrecognized gains (losses) on postretirement and other employment-related plans, changes in fair value of certain derivatives, and unrealized gains and losses on certain investments in debt and equity securities. The Company's other comprehensive (loss) income is comprised of changes in the value of an interest rate swap and changes in the market value of an investment with quoted market prices in an active market for identical instruments.

### Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board ("FASB") issued authoritative guidance which requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e. a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states. With few exceptions, the Company is no longer subject to U. S. federal, state and local tax examination by tax authorities for years prior to 2007. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as operating expenses. Accrued interest is insignificant and there are no penalties accrued at December 31, 2011. The Company believes that it has appropriate support for the income tax positions taken and to be taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS:

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 adopted the authoritative guidance during the second quarter of 2009, and its application had no impact on the Company's consolidated condensed financial statements. The Company evaluated subsequent events through the date this report was filed with the SEC.

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

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

### 3. 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. Any contingent purchase price on acquisitions completed before January 1, 2009 will increase goodwill when paid.

During 2009 the initial purchase price allocation for the 2008 acquisitions was adjusted to allocate \$2.5 million of purchase price to goodwill. These increases in goodwill primarily related to reducing the value of inventories and fixed assets for the acquisitions completed during 2008. During 2009 the Company recognized an impairment charge of \$53.0 million for goodwill and other intangibles associated with the Service Centers and SCS segments. During 2010 the Company paid \$0.2 million in contingent purchase price related to the acquisition of Falcon Pump. During 2011 the Company paid \$1.0 million in contingent purchase price related to the acquisition of Indian Fire & Safety in 2007.

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. DXP completed this acquisition to expand its pump business in the Western U.S. Goodwill of \$18.8 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of Quadna with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce.





On November 30, 2010, DXP acquired substantially all of the assets of D&F Distributors, Inc. ("D&F"). The purchase price of \$13.4 million consisted of approximately \$7.4 million paid in cash, approximately \$2.9 million in the form of promissory notes bearing interest at a rate of 5%, and approximately \$3.1 million in the form of 155,393 shares of DXP common stock. The cash portion of the purchase price was funded by borrowings under DXP's existing credit facility. DXP completed this acquisition to expand its pump business in Indiana, Kentucky, Tennessee and Ohio. Goodwill of \$5.4 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of D&F with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce.

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

On December 30, 2011, DXP acquired substantially all of the assets of C.W. Rod Tool Company ("CW Rod"). DXP acquired this business to strengthen DXP's metal working offering. DXP paid approximately \$1.1 million of DXP's common stock (35,714 shares) and approximately \$42 million in cash for CW Rod, which was borrowed during 2011 and 2012 under our recently expanded credit facility. The \$42 million of cash paid for CW Rod includes \$36.7 million paid in the form of checks which did not clear our bank until 2012. Goodwill of \$10.0 million was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. It specifically includes the expected synergies and other benefits that we believe will result from combining the operations of CW Rod with the operations of DXP and any intangible assets that do not qualify for separate recognition such as the assembled workforce.

The value assigned to the non-compete agreements and customer relationships for Quadna, D&F, KC and CW Rod were determined by discounting the estimated cash flows associated with non-compete agreements and customer relationships as of the date the acquisition was consummated. The estimated cash flows were based on estimated revenues net of operating expenses and net of capital charges for assets that contribute to the projected cash flow from these assets. The projected revenues and operating expenses were estimated based on management estimates. Net capital charges for assets that contribute to projected cash flow were based on the estimated fair value of those assets. Discount rates of 17.0% to 17.2% were deemed appropriate for valuing these assets and were based on the risks associated with the respective cash flows taking into consideration the acquired company's weighted average cost of capital.

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

|                                 |         |
|---------------------------------|---------|
| Cash                            | 3       |
| Accounts Receivable             | 15,696  |
| Inventory                       | 13,754  |
| Property and equipment          | 1,415   |
| Goodwill and intangibles        | 33,352  |
| Other assets                    | 142     |
| Assets acquired                 | 64,362  |
| Current liabilities assumed     | (5,873) |
| Non-current liabilities assumed | -       |
| Net assets acquired             | 58,489  |

The pro forma unaudited results of operations for the Company on a consolidated basis for the years ended December 31, 2009 and 2010, assuming the acquisition of businesses completed in 2010 were consummated as of January 1, 2009 follows:

|                   | Years Ended<br>December 31,                   |            |
|-------------------|---|------------|
|                   | 2009  | 2010       |
|                   | (Unaudited)                                   |            |
|                   | In Thousands,<br>except for per share<br>data |            |
| Net sales         | \$653,175                                     | \$ 689,675 |
| Net (loss) income | \$(39,967)                                    | \$ 20,843  |
| Per share data    |   |            |
| Basic Earnings    | \$(3.04)                                      | \$1.50     |
| Diluted Earnings  | \$(3.04)                                      | \$1.42     |

The pro forma unaudited results of operations for the Company on a consolidated basis for the years ended December 31, 2010 and 2011, assuming the acquisition of businesses completed in 2011 were consummated as of January 1, 2010 follows:

|                  | Years Ended<br>December 31,                   |            |
|------------------|---|------------|
|                  | 2010  | 2011       |
|                  | (Unaudited)                                   |            |
|                  | In Thousands,<br>except for per share<br>data |            |
| Net sales        | \$ 778,267                                    | \$ 903,240 |
| Net income       | \$ 22,898                                     | \$ 35,511  |
| Per share data   |   |            |
| Basic Earnings   | \$1.65  | \$2.48     |
| Diluted Earnings | \$1.56  | \$2.35     |

#### 4. PRECISION INVENTORY IMPAIRMENT IN 2009

During 2009 the Company determined that the value of inventory acquired in connection with the acquisition of Precision on September 10, 2007, was overstated by \$13.8 million because the inventory was obsolete, expired, old and/or slow moving. The \$13.8 million charge to reduce the value of this inventory is included in cost of sales for 2009.

## 5. INVENTORIES:

The carrying values of inventories are as follows:

|                      | December 31,   |           |
|----------------------|----------------|-----------|
|                      | 2010           | 2011      |
|                      | (in Thousands) |           |
| Finished goods       | \$ 94,270      | \$102,645 |
| Work in process      | 2,466          | 5,246     |
| Obsolescence reserve | (20,849)       | (13,990)  |
| Inventories          | \$ 75,887      | \$ 93,901 |

## 6. PROPERTY AND EQUIPMENT:

Property and equipment consisted of the following:

|                                      | December 31,   |           |
|--------------------------------------|----------------|-----------|
|                                      | 2010           | 2011      |
|                                      | (in Thousands) |           |
| Land                                 | \$ 1,652       | \$ 1,652  |
| Buildings and leasehold improvements | 7,508          | 7,956     |
| Furniture, fixtures and equipment    | 23,700         | 28,756    |
|                                      | 32,860         | 38,364    |
| Less – Accumulated depreciation      | (17,943)       | (21,453)  |
| Total Property and Equipment         | \$ 14,917      | \$ 16,911 |

## 7. LONG-TERM DEBT:

Long-term debt consisted of the following:

|  | December 31,   |           |
|--|----------------|-----------|
|  | 2010           | 2011      |
|  | (in Thousands) |           |
| Line of credit   | \$ 83,664      | \$110,828 |
| Term loan, payable in quarterly installments of \$2.5 million through August 2013              | 25,500         | -         |
| Unsecured notes payable to individuals, at variable rates (1.0% to 1.75% at December 31, 2010) | 630            | -         |

|  |          |           |
|--|----------|-----------|
| payable in monthly and quarterly installments through November 2011  |          |           |
| Unsecured subordinated notes payable in quarterly installments at 5% through November 2015   | 2,900    | 2,320     |
| Mortgage loan payable to financial institution, 6.25% collateralized by real estate,<br>payable in monthly installments through January 2013 | 1,857    | 1,751     |
|  | 114,551  | 114,899   |
| Less: Current portion  | (10,930) | (694)     |
| Total Long-term Debt   | \$       |           |
|  | 103,621  | \$114,205 |

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

On December 31, 2011, the LIBOR based rate of the Facility was LIBOR plus 1.5%, the prime based rate of the Facility was prime plus 0.0% and the commitment fee was 0.2%. At December 31, 2011, \$110.5 million was borrowed under the Facility at a weighted average interest rate of approximately 1.78% under the LIBOR options and \$0.3 million was borrowed at 3.25% under the prime option. 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 December 31, 2011, we had \$78.2 million available for borrowing under the Facility.

The Facility's principal financial covenants include:

**Fixed Charge Coverage Ratio** –The Facility requires that the Fixed Charge Coverage Ratio for the 12 month period ending on the last day of each quarter be not less than 1.50 to 1.0 with “Fixed Charge Coverage Ratio” defined as the ratio of (a) EBITDA for the 12 months ending on such date minus cash taxes, minus Capital Expenditures for such period (excluding acquisitions) to (b) the aggregate of interest expense paid in cash, scheduled principal payments in respect of long-term debt and current portion of capital leases for such 12-month period, determined in each case on a consolidated basis for DXP and its subsidiaries. At December 31, 2011, the Company's Fixed Charge Coverage Ratio was 14.2.

**Leverage Ratio** – The Facility requires that the Company's Leverage Ratio, determined at the end of each fiscal quarter, not exceed 4.0 to 1.0 as of the last day of each quarter. The Leverage Ratio is defined as the outstanding Indebtedness divided by EBITDA for the 12 months then ended. At December 31, 2011, the Company's Leverage Ratio was 1.49 to 1.00. Indebtedness is defined under the Facility for financial covenant purposes as: (a) all obligations of DXP for borrowed money including but not limited to senior bank debt, senior notes and subordinated debt; (b) capital leases; (c) issued and outstanding letters of credit; and (d) contingent obligations for funded indebtedness.

The following is the computation of the Leverage Ratio as of December 31, 2011 (in thousands, except for ratios):

| For the Year ended December 31, 2011 | Leverage Ratio |
|--------------------------------------|----------------|
| Income before taxes                  | \$ 51,995      |
| Interest expense                     | 3,518          |
| Depreciation and amortization        | 10,082         |
| Stock compensation expense           | 1,256          |
| Pro forma acquisition                | 10,871         |
| EBITDA                               |                |
| Reduction of closed location accrual | (123)          |
| (A) Defined EBITDA                   | \$ 77,599      |

|                 |           |
|-----------------|-----------|
| A s o f         |           |
| December 31,    |           |
| 2011            |           |
| T o t a l       | \$114,899 |
| long-term debt  |           |
| Letters of      | 951       |
| c r e d i t     |           |
| outstanding     |           |
| (B) Defined     | \$115,850 |
| indebtedness    |           |
| L e v e r a g e | 1.49      |
| Ratio (B)/(A)   |           |

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.

The Facility prohibits the payment of cash dividends on the Company's common stock.

The maturities of long-term debt for the next five years and thereafter are as follows (in thousands):

|            |         |
|------------|---------|
| 2012       | 694     |
| 2013       | 2,216   |
| 2014       | 580     |
| 2015       | 580     |
| 2016       | 110,829 |
| Thereafter | -       |

#### 8. INCOME TAXES:

The provision for income taxes consists of the following:

|            | Years Ended December 31, |          |          |
|------------|--------------------------|----------|----------|
|            | 2009                     | 2010     | 2011     |
|            | (in Thousands)           |          |          |
| Current -  |                          |          |          |
| Federal \$ | 3,849                    | \$ 7,952 | \$15,401 |
| State      | 759                      | 1,885    | 3,076    |
|            | 4,608                    | 9,837    | 18,477   |
| Deferred   | (16,678)                 | 2,914    | 2,081    |
|            | \$(12,070)               | \$12,751 | \$20,558 |

The difference between income taxes computed at the federal statutory income tax rate (35%) and the provision for income taxes is as follows:

|   | Years Ended December 31, |           |          |
|---|--------------------------|-----------|----------|
|   | 2009                     | 2010      | 2011     |
|   | (in Thousands)           |           |          |
| Income taxes computed at federal statutory rate | \$(19,069)               | \$ 11,246 | \$18,198 |
| State income taxes, net of federal benefit      | 492                      | 1,225     | 1,999    |



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|   |            |        |          |
|---|------------|--------|----------|
| N o n d e d u c t i b l e<br>impairment expense | 6,852      | -      | -        |
| Other   | (345)      | 280    | 361      |
|   | \$(12,070) | \$     | \$20,558 |
|   |            | 12,751 |          |

The net current and noncurrent components of deferred income tax balances are as follows:

|                             | December 31,   |          |
|-----------------------------|----------------|----------|
|                             | 2010           | 2011     |
|                             | (in Thousands) |          |
| Net current assets          | \$ 5,919       | \$ 4,539 |
| Net non-current assets      | 2,289          | 1,588    |
| Net non-current liabilities | -              | -        |
| Net assets (liabilities)    | \$ 8,208       | \$ 6,127 |

Deferred tax liabilities and assets were comprised of the following:

|   | December 31,   |         |
|---|----------------|---------|
|   | 2010           | 2011    |
|   | (in Thousands) |         |
| Deferred tax assets:                                  |                |         |
| Goodwill  | \$ 4,871       | \$3,575 |
| Allowance for doubtful accounts                       | 1,230          | 2,077   |
| Inventories   | 3,615          | 1,707   |
| Accruals  | 740            | 889     |
| Other   | 180            | 229     |
| Total deferred tax assets                             | 10,636         | 8,477   |
| Less valuation allowance                              | -              | -       |
| Total deferred tax assets, net of valuation allowance | 10,636         | 8,477   |
| Deferred tax liabilities                              |                |         |
| Intangibles   | (907)          | (786)   |
| Property and equipment                                | (1,421)        | (1,421) |
| Other   | (100)          | (143)   |
| Net deferred tax asset (liability)                    | \$ 8,208       | \$6,127 |

## 9. SHAREHOLDERS' EQUITY:

### Preferred Stock

The holders of Series A preferred stock are entitled to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of common stock, and are not entitled to any dividends or distributions other than in the event of a liquidation of the Company, in which case the holders of the Series A

preferred stock are entitled to a \$100 liquidation preference per share. Each share of the Series B convertible preferred stock is convertible into 28 shares of common stock and a monthly dividend per share of \$.50. The holders of the Series B convertible stock are also entitled to a \$100 liquidation preference per share after payment of the distributions to the holders of the Series A preferred stock and to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of the common stock. Of the 10,000,000 authorized shares of Preferred Stock, 8,000,000 shares are available for future designation.

#### Restricted Stock

Under a restricted stock plan approved by DXP's 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 December 31, 2011, vest 20% each year for five years after the date of grant, 33.3% each year for three years after the grant date or 10% each year for ten years after the grant date. The shares of restricted stock granted to non-employee directors of DXP vest 100% one year after the grant date. The Restricted Stock Plan provides for a grant to each non-employee director of DXP, consisting of the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on the July 1 of the award year. 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, granted and available for future grant under the Restricted Stock Plan at December 31, 2011

|  |         |
|--|---------|
| Number of shares authorized for grants         | 600,000 |
| Number of shares granted                       | 611,954 |
| Number of shares forfeited                     | 60,738  |
| Number of shares available for future grants   | 48,784  |
| Weighted-average grant price of granted shares | \$17.19 |

Changes in non-vested restricted stock for 2009, 2010 and 2011 were as follows:

|                                 | Number<br>Of<br>Shares | Weighted<br>Average<br>Grant<br>Price |
|---------------------------------|------------------------|---------------------------------------|
| Non-vested at December 31, 2009 | 223,448                | \$15.29                               |
| Granted                         | 93,781                 | \$15.92                               |
| Forfeited                       | (37,287)               | \$17.08                               |
| Vested                          | (99,886)               | \$12.32                               |
| Non-vested at December 31, 2010 | 180,056                | \$16.15                               |
| Granted                         | 117,292                | \$24.79                               |
| Forfeited                       | (687)                  | \$17.29                               |
| Vested                          | (68,069)               | \$14.40                               |
| Non-vested at December 31, 2011 | 228,592                | \$21.10                               |

Compensation expense recognized for restricted stock in the years ended December 31, 2009, 2010 and 2011 was \$1,555,000, \$973,000 and 1,256,000 respectively. Related income tax benefits recognized in earnings were approximately \$622,000, \$389,000 and \$502,000 in 2009, 2010 and 2011, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$2,423,000 and \$4,051,000, respectively, at December 31, 2010 and 2011. As of December 31, 2011, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 29.6 months.

## Stock Options

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The DXP Enterprises, Inc. 1999 Employee Stock Option Plan, the DXP Enterprises, Inc. Long-Term Incentive Plan and the DXP Enterprises, Inc. Director Stock Option Plan authorized the grant of options to purchase 1,800,000, 660,000 and 400,000 shares of the Company's common stock, respectively. In accordance with these stock option plans that were approved by the Company's shareholders, options were granted to key personnel for the purchase of shares of the Company's common stock at prices not less than the fair market value of the shares on the dates of grant. Most options could be exercised not earlier than 12 months nor later than 10 years from the date of grant. No future grants will be made under these stock option plans. Activity during 2009, 2010 and 2011 with respect to the stock options follows:

|   | Options<br>Price<br>Per Share | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|---|-------------------------------|--|---------------------------------|
| Outstanding and exercisable at December 31, 2008          | 58,000 \$1.25 - \$3.36        | \$2.33                                   | \$ 712,000                      |
| Exercised   | (8,000) \$1.25                | \$1.25                                   | \$ 85,000                       |
| Outstanding and exercisable at December 31, 2009          | 50,000 \$1.25 - \$3.36        | \$2.50                                   | \$ 529,000                      |
| Exercised during 2010                                     | (50,000) \$1.25 - \$3.36      | \$2.50                                   | \$ 489,000                      |
| Outstanding and exercisable at December 31, 2010 and 2011 | -                             | -  | -                               |

Cash received from stock options exercised during 2009, 2010 and 2011 was \$10,000, \$125,000 and zero, respectively. The weighted average remaining contractual life was 4.0 years at December 31, 2009.

### Certain Equity Related Transactions

During 2009 and 2010, employees and directors of DXP exercised non-qualified stock options. DXP received a tax deduction for the amount of the difference between the exercise price and the fair market value of the shares recognized as income by the individuals exercising the options. The after tax benefit of the tax deduction is accounted for as an increase in paid-in capital.

### Earnings Per Share

Basic earnings per share is computed based on weighted average shares outstanding and excludes dilutive securities. Diluted earnings per share is computed including the impacts of all potentially dilutive securities. The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2009, 2010 and 2011.

|   | 2009                                     | 2010      | 2011      |
|---|--|-----------|-----------|
|   | (in Thousands, except per share amounts) |           |           |
| <b>Basic:</b>   |  |           |           |
| Basic weighted average shares outstanding                               | 13,117                                   | 13,821    | 14,301    |
| Net income (loss)   | \$(42,412)                               | \$ 19,381 | \$ 31,437 |
| Convertible preferred stock dividend                                    | (90)                                     | (90)      | (90)      |
| Net income (loss) attributable to common shareholders                   | \$(42,502)                               | \$ 19,291 | \$ 31,347 |
| Per share amount  | \$(3.24)                                 | \$1.40    | \$2.19    |
| <b>Diluted:</b>   |  |           |           |
| Basic weighted average shares outstanding                               | 13,117                                   | 13,821    | 14,301    |
| Net effect of dilutive stock options based on the treasury stock method | -  | 7         | -         |
| Assumed conversion of convertible notes                                 | -  | 153       | -         |
| Assumed conversion of convertible preferred stock                       | -  | 840       | 840       |
| Total common and common equivalent shares outstanding                   | 13,117                                   | 14,821    | 15,141    |
| Net income (loss) attributable to common shareholders                   | \$(42,502)                               | \$ 19,291 | \$ 31,347 |
| Interest on convertible notes, net of income taxes                      | -  | 142       | -         |
| Convertible preferred stock dividend                                    | -  | 90        | 90        |
| Net income (loss) for diluted earnings per share                        | \$(42,502)                               | \$ 19,523 | \$ 31,437 |
| Per share amount  | \$(3.24)                                 | \$1.32    | \$2.08    |

### 10. COMMITMENTS AND CONTINGENCIES:

The Company leases equipment, automobiles and office facilities under various operating leases. The future minimum rental commitments as of December 31, 2011, for non-cancelable leases are as follows (in thousands):

|            |          |
|------------|----------|
| 2012       | \$11,191 |
| 2013       | 8,765    |
| 2014       | 9,207    |
| 2015       | 5,816    |
| 2016       | 2,938    |
| 2017       | 1,331    |
| Thereafter | 5,462    |

Rental expense for operating leases was \$12,201,000, \$12,495,000 and \$14,151,000 for the years ended December 31, 2009, 2010 and 2011, respectively.

In 2004, DXP and DXP's vendor of fiberglass reinforced pipe were sued in Louisiana by a major energy company regarding the failure of Bondstrand PSX JFC pipe, a recently introduced type of fiberglass reinforced pipe which had been installed on four energy production platforms. Plaintiff alleges negligence, breach of contract, warranty and that damages exceed \$20 million. DXP believes the failures were not caused by work performed by DXP. DXP intends to vigorously defend these claims. DXP's insurance carrier has agreed, under a reservation of rights to deny coverage, to provide a defense against these claims. The maximum amount of our insurance coverage, if any, is \$6 million. Under certain circumstance, our insurance may not cover this claim. DXP currently believes the claim is without merit and the possibility of the claim having a material adverse effect on our business, financial condition, cash flows or results of operations is remote.

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

#### 11. EMPLOYEE BENEFIT PLANS:

The Company offers a 401(K) plan which is eligible to substantially all employees. During 2011, part of 2010 and part of 2009, the Company elected to match employee contributions at a rate of 50 percent of up to 4 percent of salary deferral. During 2009 the Company stopped matching employee contributions. During 2010 the Company resumed matching of employee contributions. The Company contributed \$823,000, \$540,000 and \$1,537,000 to the 401(K) plan in the years ended December 31, 2009, 2010 and 2011, respectively.

#### 12. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Effective January 1, 2008, we 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 marketable securities and an interest rate swap to which the Company was a party, 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.

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The following presents the changes in Level 3 liabilities for 2009, 2010, and 2011 (in thousands):

|  | 2009        | 2010     | 2011 |
|--|-------------|----------|------|
| Fair value at January 1,   | \$ ( 1,202) | \$ ( 42) | -    |
| Realized and unrealized gains included in other comprehensive income | 1,160       | 42       | -    |
| Fair value at December 31,   | ( 42) \$    | --       | --   |

During 2011, the Company paid \$1,572,000 for an investment with quoted market prices in an active market for identical instruments. The \$106,000 increase in the market value of this investment was included in other comprehensive income in 2011.

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 the Facility. Through January 11, 2010, this interest rate swap effectively fixed the interest rate on \$40 million of floating rate LIBOR borrowings under the Facility at one-month LIBOR of 3.68% plus the margin in effect under the Facility. Amounts paid or received in connection with the swap were included in interest expense. 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 13 "Other Comprehensive Income" for gain, net of income taxes, on the interest rate swap.

The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. In 2009, the Company recorded a charge of \$53.0 million related to the impairment of goodwill and other tangibles at the Service Centers, SCS and PFI reporting units. The fair market value of these reporting units was determined using the income approach and Level 3 inputs, which required management to make estimates about future cash flows. Management estimated the amount and timing of future cash flows based on its experience and knowledge of the business environment in which the reporting units operate.

### 13. 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. During 2009 and 2010 the Company had other comprehensive income related to changes in interest rates in connection with an interest rate swap. At December 31, 2009, 2010 and 2011, the accumulated derivative (loss) income, net of income tax was \$(26,000), zero and zero, respectively. During 2011, the Company had other comprehensive income of \$106,000 (\$64,000 net of tax) related to changes in the market value of an investment with quoted market prices in an active market for identical instruments. At December 31, 2011, the accumulated gain on an investment, net of income tax was \$64,000. Comprehensive income (loss) for the years ending December 31, 2009, 2010 and 2011 was \$(41,717,000), \$19,407,000, and \$31,501,000, respectively.

### 14. SEGMENT DATA:

The Service Centers segment is engaged in providing maintenance, repair and operating products, equipment and services, including logistics capabilities, to industrial customers. The Service Centers segment provides a wide range of MRO products in the rotating equipment, bearing, power transmission equipment, fastener, industrial supplies,

metal working and safety product categories. The Innovative Pumping Solutions segment fabricates and assembles custom-made engineered pump packages. The Supply Chain Services segment manages all or part of customers' supply chains, including inventory.

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.

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

|  | Service<br>Centers | Innovative<br>Pumping<br>Solutions | Supply<br>Chain<br>Services | Total     |
|--|--------------------|------------------------------------|-----------------------------|-----------|
| <b>2011</b>                              |                    |                                    |                             |           |
| Sales                                    | \$560,233          | \$102,305                          | \$144,467                   | \$807,005 |
| Operating income for reportable segments | 64,491             | 16,920                             | 8,455                       | 89,866    |
| Identifiable assets at year end          | 293,925            | 51,058                             | 58,192                      | 403,175   |
| Capital expenditures                     | 3,713              | 310                                | 73                          | 4,096     |
| Depreciation                             | 2,908              | 326                                | 276                         | 3,510     |
| Amortization                             | 4,725              | 675                                | 1,172                       | 6,572     |
| Interest expense                         | 2,073              | 986                                | 459                         | 3,518     |
| <b>2010</b>                              |                    |                                    |                             |           |
| Sales                                    | \$452,719          | \$ 77,024                          | \$126,459                   | \$656,202 |
| Operating income for reportable segments | 50,549             | 10,335                             | 7,120                       | 68,004    |
| Identifiable assets at year end          | 234,773            | 40,038                             | 45,813                      | 320,624   |
| Capital expenditures                     | 1,075              | 17                                 | 92                          | 1,184     |
| Depreciation                             | 2,987              | 368                                | 389                         | 3,744     |
| Amortization                             | 4,055              | 604                                | 1,165                       | 5,824     |
| Interest expense                         | 4,115              | 700                                | 393                         | 5,208     |
| <b>2009</b>                              |                    |                                    |                             |           |
| Sales                                    | \$391,060          | \$ 55,913                          | \$136,253                   | \$583,226 |
| Operating income for reportable segments | 24,398             | 7,519                              | 5,548                       | 37,465    |
| Identifiable assets at year end          | 199,937            | 22,604                             | 48,386                      | 270,927   |
| Capital expenditures                     | 1,475              | 29                                 | 89                          | 1,593     |
| Depreciation                             | 3,458              | 348                                | 454                         | 4,260     |
| Amortization                             | 5,683              | 338                                | 1,195                       | 7,216     |
| Interest expense                         | 3,890              | 831                                | 524                         | 5,245     |

|  | Years Ended December 31, |           |           |
|--|--------------------------|-----------|-----------|
|  | 2009                     | 2010      | 2011      |
| Operating income for reportable segments     | \$ 37,465                | \$ 68,004 | \$ 89,866 |
| Adjustment for:                              |                          |           |           |
| Amortization of intangibles                  | 7,216                    | 5,824     | 6,572     |
| Impairment of goodwill and other intangibles | 52,951                   | -         | -         |
| Corporate and other expense, net             | 26,630                   | 25,089    | 27,809    |
| Total operating income (loss)                | (49,332)                 | 37,091    | 55,485    |
| Interest expense, net                        | 5,245                    | 5,208     | 3,518     |

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|                                   |            |           |           |
|-----------------------------------|------------|-----------|-----------|
| Other expenses (income), net      | (95)       | (249)     | (28)      |
| Income (loss) before income taxes | \$(54,482) | \$ 32,132 | \$ 51,995 |

## 15. QUARTERLY FINANCIAL INFORMATION (Unaudited)

Summarized quarterly financial information for the years ended December 31, 2009, 2010 and 2011 is as follows:

|  | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|--|------------------|-------------------|------------------|-------------------|
| 2009   |                  |                   |                  |                   |
| Sales  | \$ 157.6         | \$ 144.4          | \$ 143.4         | \$ 137.8          |
| Gross profit                                 | 46.1             | 41.4              | 40.8             | 23.1              |
| Goodwill and other<br>intangibles impairment | -                | -                 | -                | (53.0)            |
| Net income (loss)                            | 3.2              | 2.2               | 2.7              | (50.5)            |
| Earnings (loss) per share -<br>basic         | 0.24             | 0.16              | 0.20             | (3.84)            |
| Earnings (loss) per share -<br>diluted       | 0.23             | 0.15              | 0.19             | (3.84)            |
| 2010   |                  |                   |                  |                   |
| Sales  | \$ 147.0         | \$ 167.3          | \$ 172.2         | \$ 169.7          |
| Gross profit                                 | 42.0             | 47.9              | 48.9             | 49.6              |
| Net income                                   | 3.6              | 4.6               | 5.3              | 5.9               |
| Earnings per share - basic                   | 0.27             | 0.33              | 0.38             | 0.41              |
| Earnings per share - diluted                 | 0.26             | 0.31              | 0.36             | 0.39              |
| 2011   |                  |                   |                  |                   |
| Sales  | \$ 183.1         | \$ 197.7          | \$ 207.9         | \$ 218.3          |
| Gross profit                                 | 52.4             | 57.3              | 59.5             | 62.6              |
| Net income                                   | 6.3              | 7.6               | 8.3              | 9.2               |
| Earnings per share - basic                   | 0.44             | 0.53              | 0.58             | 0.64              |
| Earnings per share - diluted                 | 0.42             | 0.50              | 0.55             | 0.61              |

The sum of the individual quarterly earnings per share amounts may not agree with year-to-date earnings per share as each quarter's computation is based on the weighted average number of shares outstanding during the quarter, the weighted average stock price during the quarter and the dilutive effects of the stock options and restricted stock in each quarter.

## ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## ITEM 9A. Controls and Procedures

## Disclosure Controls and Procedures

DXP carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness as of December 31, 2011, of the design and operation of DXP's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Disclosure controls and procedures are the controls and other procedures of DXP that are designed to ensure that information required to be disclosed by DXP in the reports that it files or submits under the Securities Exchange

Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission (the "Commission"). Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by DXP in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that DXP's disclosure controls and procedures were effective as of the end of the period covered by this Report.

Internal Control Over Financial Reporting

(A) Management's Annual Report on Internal Control Over Financial Reporting

Management's report on the Company's internal control over financial reporting is included on page 32 of this Report under the heading Management's Report on Internal Control Over Financial Reporting.

The effectiveness of our internal control over financial reporting at December 31, 2011 has been audited by Hein & Associates LLP, the independent registered public accounting firm that also audited our financial statements.

Their report is included on page 31 of this Report under the heading Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting.

(B) Changes in Internal Control over Financial Reporting

None

ITEM 9B. Other Information

None.



PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

The information required by this item will be included in our Definitive Proxy statement for the 2012 Annual Meeting of Shareholders that we will file with the SEC within 120 days of the end of the fiscal year to which this Report relates (the "Proxy Statement") and is hereby incorporated by reference thereto.

ITEM 11. Executive Compensation

The information required by this item will be included in the Proxy Statement and is hereby incorporated by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item will be included in the Proxy Statement and is hereby incorporated by reference.

ITEM 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item will be included in the Proxy Statement and is hereby incorporated by reference.

ITEM 14. Principal Accounting Fees and Services.

The information required by this item will be included in the Proxy Statement and is hereby incorporated by reference.

PART IV

ITEM 15. Exhibits, Financial Statement Schedules.

(a) Documents included in this report:

1. Financial Statements (included under Item 8):

DXP Enterprises, Inc. Page  
and Subsidiaries:

Reports of Independent 30  
Registered Public  
Accounting Firm

Management Report on 32  
Internal Controls

Consolidated Balance 33  
Sheets

Consolidated Statements 34  
of Operations

Consolidated Statements 35  
of Shareholders' Equity

Consolidated Statements 36  
of Cash Flows

Notes to Consolidated 37  
Financial Statements

2. Financial Statement Schedules:

Schedule II – Valuation and Qualifying Accounts

All other schedules have been omitted since the required information is not significant or is included in the Consolidated Financial Statements or notes thereto or is not applicable.

3. Exhibits:

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed with the Commission.

Exhibit

No. Description

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

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

- 3.3 Amendment No. 1 to Bylaws of DXP Enterprises, Inc. (incorporated by reference to Exhibit A to the Company's Current Report on Form 8-K, filed with the Commission on July 28, 2011).
- 4.1 Form of Common Stock certificate (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998).
- 4.2 See Exhibit 3.1 for provisions of the Company's Restated Articles of Incorporation, as amended, defining the rights of security holders.
- 4.3 See Exhibit 3.2 for provisions of the Company'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 DXP Enterprises, Inc. 1999 Employee Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1999, filed with the Commission on August 16, 1999).
- +10.2 DXP Enterprises, Inc. 1999 Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1999), filed with the Commission on August 16, 1999.
- +10.3 DXP Enterprises, Inc. Long Term Incentive Plan, as amended (incorporated by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998).
- +10.4 Amendment Number One to DXP Enterprises, Inc. Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, filed with the Commission on March 11, 2004).
- +10.5 Employment Agreement dated effective as of January 1, 2004, between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, filed with the Commission on March 11, 2004).
- +10.6 Employment Agreement dated effective as of June 1, 2004, between DXP Enterprises, Inc. and Mac McConnell (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004, filed with the Commission on May 6, 2004).
- +10.7 Amendment Number One to DXP Enterprises, Inc. 1999 Employee Stock Option Plan (incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Commission on March 30, 2005).
- +10.8 Summary Description of Director Fees (incorporated by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Commission on March 30, 2005).
- +10.9 Summary Description of Executive Officer Cash Bonus Plan (incorporated by reference to Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Commission on March 30, 2005).
- +10.10 Amendment Number Two to DXP Enterprises, Inc. Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Commission on March 30, 2005).
- +10.11 DXP Enterprises, Inc. 2005 Restricted Stock Plan (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, (filed with the Commission on March 10, 2006).
- +10.12 Amendment Number One to Employment Agreement dated effective as of January 1, 2004, between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.1 to the Company's Current

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Report on Form 8-K, filed with the Commission on July 26, 2006).

+10.13 Amendment No. One to DXP Enterprises, Inc. 2005 Restricted Stock Plan (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Commission on July 26, 2006).

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- 10.14 Stock Purchase Agreement among DXP Enterprises, Inc., as Purchaser, Precision Industries, Inc., and the selling stockholders dated August 19, 2007, (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Commission on August 21, 2007).
- 10.15 Asset Purchase Agreement among DXP Enterprises, Inc., as Purchaser, Lone Wolf Rental, LLC, Indian Fire and Safety, Inc., and the other parties named therein dated October 18, 2007, (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Commission on October 22, 2007).
- 10.16 Stock Purchase Agreement among DXP Enterprises, Inc., as Purchaser, Vertex Corporate Holdings, Inc., the stockholders of Vertex Corporate Holdings, Inc. and Watermill-Vertex Enterprises, LLC, dated August 28, 2008, (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Commission on August 29, 2008).
- 10.17 Credit Agreement among DXP Enterprises, Inc., as Borrower, and Bank of America, N.A., as Syndication Agent, and Wells Fargo Bank, National Association, as Lead Arranger and Administrative Agent for the Lenders and the Lenders party thereto dated August 28, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Commission on August 29, 2008 and the Company's Current Report on Form 8-K/A, filed with the Commission on September 23, 2010).
- 10.18 Amendment Number Two to Employment Agreement dated effective January 1, 2004 between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on May 22, 2010).
- 10.19 Exhibits and schedules to the Credit Agreement among DXP Enterprises, Inc., as Borrower, and Bank of America, N.A., as Syndication Agent, and Wells Fargo Bank, National Association, as Lead Arranger and Administrative Agent for the Lenders and the Lenders party thereto, dated August 28, 2008 (incorporated by reference to Amendment Number Two to the Company's Current Report on Form 8-K/A, filed with the Commission on September 23, 2010).
- 10.20 Amendment Number One to Credit Agreement among DXP Enterprises, Inc., as Borrower, and Bank of America, N.A., as Syndication Agent, and Wells Fargo Bank, National Association, as Lead Arranger and Administrative Agent for the Lenders and the Lenders party thereto, dated August 28, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Commission on March 16, 2010).
- 10.21 Asset Purchase Agreement, dated as of April 1, 2010, whereby DXP Enterprises, Inc. acquired the assets of Quadna, Inc. (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).
- 10.22 Asset Purchase Agreement, dated as of November 22, 2010, whereby DXP Enterprises, Inc. acquired the assets of D&F Distributors, Inc. (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 November 23, 2010).
- 10.23 Amendment Number One to Employment Agreement dated effective June 1, 2004 between DXP Enterprises, Inc. and Mac McConnell (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on May 9, 2011).
- 10.24 David Little Equity Incentive Program dated May 4, 2011 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on May 9, 2011).

10.25 Amendment Number Two to Credit Agreement among DXP Enterprises, inc., as Borrower, and Bank of America, N.A., as Syndication Agent, and Wells Fargo Bank, National Association, as Lead Arranger and Administrative Agent for the Lenders and the Lenders party thereto, dated August 28, 2008 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on July 27, 2011).

\*10.26 Amendment Number Three to Credit Agreement among DXP Enterprises, inc., as Borrower, and Bank of America, N.A., as Syndication Agent, and Wells Fargo Bank, National Association, as Lead Arranger and Administrative Agent for the Lenders and the Lenders party thereto, dated August 28, 2008.

\*10.27 Asset Purchase Agreement, dated as of October 10, 2011, whereby DXP Enterprises, Inc. acquired the assets of Kenneth Crosby.

\*10.28 Asset Purchase Agreement, dated as of December 30, 2011, whereby DXP Enterprises, Inc. acquired the assets of C.W. Rod Tool Company.

18.1 Letter of Independent Registered Public Accounting Firm Regarding Change in Accounting Principle (incorporated by reference to Exhibit 18.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2008, filed with the Commission on May 12, 2008.)

\*21.1 Subsidiaries of the Company.

\*23.1 Consent of Hein & Associates LLP, Independent Registered Public Accounting Firm.

\*31.1 Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act, as amended.

\*31.2 Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act, as amended.

\*32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.

\*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, as amended.

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

+ Indicates a management contract or compensation plan or arrangement.

The Company undertakes to furnish to any shareholder so requesting a copy of any of the exhibits to this Report on upon payment to the Company of the reasonable costs incurred by the Company in furnishing any such exhibit.



INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S  
REPORT ON FINANCIAL STATEMENT SCHEDULE

To the Board of Directors and Shareholders  
DXP Enterprises, Inc. and Subsidiaries  
Houston, Texas

We have audited, in accordance with auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of DXP Enterprises, Inc. and Subsidiaries included in this Form 10-K and have issued our report thereon dated March 9, 2012. Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial statement schedule listed in Item 15 herein (Schedule II-Valuation and Qualifying Accounts) is the responsibility of the Company's management and is presented for the purpose of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. The financial statement schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects with the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Hein & Associates, LLP  
Houston, Texas  
March 9, 2012

| SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS<br>DXP ENTERPRISES, INC.<br>Years Ended December 31, 2011, 2010 and 2009<br>(in thousands) |                                    |                                    |                                 |             |                              |  |
|--|------------------------------------|------------------------------------|---------------------------------|-------------|------------------------------|--|
| Description  | Balance at<br>Beginning<br>of Year | Charged to<br>Cost and<br>Expenses | Charged to<br>Other<br>Accounts | Deductions  | Balance<br>At End<br>of Year |  |
| Year ended   |                                    |                                    |                                 |             |                              |  |
| December 31, 2011  |                                    |                                    |                                 |             |                              |  |
| Deducted from  | \$ 3,540                           | \$ 3,101                           | \$ 193                          | \$ 632(1)   | \$ 6,202                     |  |
| assets accounts  |                                    |                                    |                                 |             |                              |  |
| Allowance for  |                                    |                                    |                                 |             |                              |  |
| doubtful accounts  |                                    |                                    |                                 |             |                              |  |
| Year ended   |                                    |                                    |                                 |             |                              |  |
| December 31, 2010  |                                    |                                    |                                 |             |                              |  |
| Deducted from  | \$ 3,006                           | \$ 679                             | \$ -                            | \$ 145(1)   | \$ 3,540                     |  |
| assets accounts  |                                    |                                    |                                 |             |                              |  |
| Allowance for  |                                    |                                    |                                 |             |                              |  |
| doubtful accounts  |                                    |                                    |                                 |             |                              |  |
| Year ended   |                                    |                                    |                                 |             |                              |  |
| December 31, 2009  |                                    |                                    |                                 |             |                              |  |
| Deducted from  | \$ 3,494                           | \$ 675                             | \$ -                            | \$ 1,163(1) | \$ 3,006                     |  |
| assets accounts  |                                    |                                    |                                 |             |                              |  |

|   |    |    |    |   |    |   |             |
|---|----|----|----|---|----|---|-------------|
| Allowance for doubtful accounts             |    |    |    |   |    |   |             |
| Valuation allowance for deferred tax assets | \$ | 16 | \$ | - | \$ | - | \$ (16) (2) |

(1) Uncollectible accounts written off, net of recoveries.

(2) Reduction results from expiration or use of state net operating loss carryforwards.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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/DAVID R. LITTLE  
 David R. Little  
 Chairman of the Board,  
 President and Chief Executive Officer

Dated: March 9, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| NAME                                      | TITLE   | DATE          |
|---|---|---------------|
| /s/David R. Little<br>David R. Little     | Chairman of the Board, President<br>Chief Executive Officer and Director<br>(Principal Executive Officer)       | March 9, 2012 |
| /s/Mac McConnell<br>Mac McConnell         | Senior Vice President/Finance and<br>Chief Financial Officer<br>(Principal Financial and Accounting<br>Officer) | March 9, 2012 |
| /s/Cletus Davis<br>Cletus Davis           | Director  | March 9, 2012 |
| /s/Timothy P. Halter<br>Timothy P. Halter | Director  | March 9, 2012 |
| /s/Kenneth H. Miller<br>Kenneth H. Miller | Director  | March 9, 2012 |

