

DXP ENTERPRISES INC
Form 10-K
March 28, 2018

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, 2017

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

Commission file number 0-21513

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.01 Par Value NASDAQ
(Title of Class) (Name of exchange on which registered)

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

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

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.

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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).

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

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

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

Aggregate market value of the registrant's Common Stock held by non-affiliates of registrant as of June 30, 2017: \$536,658,521

Number of shares of registrant's Common Stock outstanding as of March 21, 2018: 17,358,186.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the annual meeting of shareholders to be held in 2018 are incorporated by reference into Part III hereof.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Report”) contains statements that constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Such statements can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “might”, “estimates”, “will”, “should”, “could” or “anticipates”, or the negative thereof, other variations thereon, or comparable terminology, or by discussions of strategy. Any such forward-looking statements are not guarantees of future performance and may involve significant risks and uncertainties, and actual results may vary materially from those discussed in the forward-looking statements as a result of various factors. These factors include the effectiveness of management’s strategies and decisions, our ability to implement our internal growth and acquisition growth strategies, general economic and business conditions specific to our primary customers, changes in government regulations, our ability to effectively integrate businesses we may acquire, our success in remediating our internal control weaknesses, new or modified statutory or regulatory requirements, availability of materials and labor, inability to obtain or delay in obtaining government or third-party approvals and permits, non-performance by third parties of their contractual obligations, unforeseen hazards such as weather conditions, acts of war or terrorist acts and the governmental or military response thereto, cyber-attacks adversely affecting our operations, other geological, operating and economic considerations and declining prices and market conditions, including reduced oil and gas prices and supply or demand for maintenance, repair and operating products, equipment and service, and our ability to obtain financing on favorable terms or amend our credit facilities

as needed. This Report identifies other factors that could cause such differences. We cannot assure that these are all of the factors that could cause actual results to vary materially from the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors", and elsewhere in this Report. We assume no obligation and do not intend to update these forward-looking statements. Unless the context otherwise requires, references in this Report to the "Company", "DXP", "we" or "our" shall mean DXP Enterprises, Inc., a Texas corporation, together with its subsidiaries.

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PART I

ITEM 1. Business

Company Overview

DXP was incorporated in Texas in 1996 to be the successor to SEPCO Industries, Inc., 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 energy and industrial customers. The Company is organized into three business segments: Service Centers, Supply Chain Services and Innovative Pumping Solutions. Sales, operating income, and other financial information for 2015, 2016 and 2017, and identifiable assets at the close of such years for our business segments are presented in Note 18 of the Notes to Consolidated Financial Statements “financial statements” in Item 8 of this Report.

Our total sales have increased from \$125 million in 1996 to \$1.0 billion in 2017 through a combination of internal growth and business acquisitions. At December 31, 2017 we operated from 176 locations in thirty-four states in the U.S., nine provinces in Canada, Dubai and one state in Mexico, serving more than 50,000 customers engaged in a variety of industrial end markets. We have grown sales and profitability by adding additional products, services, locations 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 and emails may be sent to 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 2016 sales as reported by Industrial Distribution magazine, we were the 19th 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, as 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:

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 demand 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 product distributors are expanding their product coverage to eliminate second-tier distributors and become a “one stop source”.

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We believe we have increased our competitive advantage through our traditional fabrication of integrated system pump packages and integrated supply programs, which are designed to address our customers' 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 our specific lines of products and product categories to offering a fully integrated supply package in which we assume procurement and management functions, which can include 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

The Company is organized into three business segments: Service Centers ("SC"), Supply Chain Services ("SCS") and Innovative Pumping Solutions ("IPS"). Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives and provide a framework for timely and rational allocation of resources within our businesses. The following table sets forth DXP's sales recognition by business segments as of December 31, 2017. See Results of Operations under Item 7, "Management Discussion and Analysis of Financial Condition and Results of Operations" for further information on our segments' financial results.

2017 Sales					
Segment (in thousands)	% of Sales	End-Markets	Locations	Employees	
SC	\$ 641,275	63.7 %	Oil & Gas, Food & Beverage, General Industrial, Chemical & Petrochemical, Transportation	161 service centers 4 distribution centers	1,463
SCS	\$ 161,477	16.0 %	Oil & Gas Food & Beverage, Mining & Transportation	67 customer facilities	271
IPS	\$ 204,030	20.3 %	Oil & Gas Mining Utilities	11 fabrication facilities	555

Service Centers

The Service Centers are engaged in providing MRO products, equipment and integrated services, including technical expertise and logistics capabilities, to energy and 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 manufacturers. As a first-tier distributor, we are able to reduce our customers' costs and improve efficiencies in the supply chain. We offer a wide range of industrial MRO products, equipment and integrated services through a continuum of customized and efficient MRO solutions. We also provide services such as field safety supervision, in-house and field repair and predictive maintenance.

A majority of our Service Center segment sales are derived from customer purchase orders for products. Sales are directly solicited from customers by our sales force. DXP Service Centers are stocked and staffed with knowledgeable sales associates and backed by a centralized customer service team of experienced industry professionals. At December 31, 2017, our Service Centers' products and services were distributed from 161 service centers and 4 distribution centers.

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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 and service 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.

The Service Centers segment's long-lived assets are located in the United States, Canada, Dubai and Mexico. Approximately 12.5% of the Service Centers segment's revenues were in Canada and the remainder was virtually all in the U.S. Our foreign operations are subject to certain unique risks, which are more fully disclosed in Item 1A "Risk Factors," "Risks Associated with Conducting Business in Foreign Countries."

At December 31, 2017, the Service Centers segment had approximately 1,463 employees, all of whom were full-time.

Supply Chain Services

DXP's Supply Chain Services (SCS) segment manages all or part of its customers' supply chains, including procurement and inventory management. The SCS segment enters into long-term contracts with its customers that can be cancelled on little or no notice under certain circumstances. The SCS segment provides fully outsourced MRO solutions for sourcing MRO products including, but not limited to, the following: inventory optimization and management; store room management; transaction consolidation and control; vendor oversight and procurement cost optimization; productivity improvement services; and customized reporting. 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 MRO products 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 MRO products 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 customers' businesses and industries have allowed us to design standardized programs that are flexible enough to be fully adaptable to address our customers' unique MRO products supply chain challenges. These standardized programs include:

- SmartAgreement, a planned, pro-active MRO products procurement solution for MRO categories leveraging DXP's local 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, which allows for inventory-level optimization, user accountability and item usage reduction by an initial 20-40%.
- 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 listed above 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.

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At December 31, 2017, the Supply Chain Services segment operated supply chain installations in 67 of our customers' facilities.

Virtually all of the SCS segment's long-lived assets are in the U.S. Approximately 1.4% of the SCS segment's 2017 revenues were recognized in Canada and 98.6% were in the U.S.

At December 31, 2017, the Supply Chain Services segment had approximately 271 employees, all of whom were full-time.

Innovative Pumping Solutions

DXP's Innovative Pumping Solutions® (IPS) segment provides integrated, custom pump skid packages, pump remanufacturing and manufactures branded private label pumps to meet the capital equipment needs of our global customer base. Our IPS segment provides a single source for engineering, systems design and fabrication for unique customer specifications.

Our sales of integrated pump packages, remanufactured pumps or branded private label pumps are generally derived from customer purchase orders containing the customers' unique specifications. Sales are directly solicited from customers by our dedicated sales force.

DXP's engineering staff can design a complete custom pump package to meet our 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. Finite Elemental Analysis 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 manufacturer certified personnel. Pump packages require MRO products and original equipment manufacturers' (OEM) equipment such as pumps, motors, valves, and consumable products, such as welding supplies. DXP leverages its MRO product inventories and breadth of authorized products to lower the total cost and maintain the quality of our pump packages.

DXP's fabrication facilities provide convenient technical support and pump repair services. The facilities contain state of the art equipment to provide the technical expertise our customers require including, but not limited to, the following:

- Structural welding
- Pipe welding
- Custom skid assembly
- Custom coatings
- Hydrostatic pressure testing
- Mechanical string testing

Examples of our innovative pump packages include, but are not limited to:

- Diesel and electric driven firewater packages
- Pipeline booster packages
- Potable water packages
- Pigging pump packages

·Lease Automatic Custody Transfer (LACT) charge units

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- Chemical injection pump packages wash down units
- Seawater lift pump packages
- Jockey pump packages
- Condensate pump packages
- Cooling water packages
- Seawater/produced water injection packages
 - Variety of packages to meet customer required industry specifications such as API, ANSI and NFPA

At December 31, 2017, the Innovative Pumping Solutions segment operated out of 11 facilities, 9 of which are located in the United States and two in Canada.

Approximately 6.4% of the IPS segment's long-lived assets are located in Canada and the remainder were located in the U.S. Approximately 8.2% of the IPS segment's 2017 revenues were recognized in Canada and 91.8% were in the U.S.

At December 31, 2017, the IPS segment had approximately 555 employees, all of whom were full-time.

Total backlog, representing firm orders for the IPS segment products that have been received and entered into our production systems, was \$104.1 million and \$68.8 million at December 31, 2017 and 2016, respectively.

Products

Most industrial customers currently purchase their MRO products 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 SKUs and provide customers with access to more than 1,000,000 items. Given our breadth of product and our industrial distribution customers' focus around specific product categories, we have become customer driven experts in five key product categories. As such, our three business segments are supported by the following five key product categories: 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:

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 disposal of produced water and crude oil pipeline service; and air-operated diaphragm pumps. We also provide a large variety of pump accessories.

Bearings & Power Transmission. Our bearing products include several types of mounted and un-mounted 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 sell a broad range of safety products including eye and face protection, first aid, hand protection, hazardous material handling, instrumentation and respiratory protection products. Additionally, we provide safety services including hydrogen sulfide (H₂S) gas protection and safety, specialized and standby fire protection, safety supervision, training, monitoring, equipment rental and consulting. Our safety services include safety supervision, medic services, safety audits, instrument repair and calibration, training, monitoring, equipment rental and consulting.

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We acquire our products through numerous OEMs. We are authorized to distribute certain manufacturers' products only in specific geographic areas. All of our oral or written distribution authorizations are subject to cancellation by the manufacturer, some upon little or no notice. For the last three fiscal years, no manufacturer provided products that accounted for 10% or more of our revenues.

Over 90% of our business relates to sales of products. Service revenues are less than 10% of sales.

The Company has operations in the United States of America, Canada, Dubai, and Mexico. Information regarding financial data by geographic areas is set forth in Note 18 of the Notes to Consolidated Financial Statements.

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 34 acquisitions across our three business segments. Below is a summary of recent acquisitions since the beginning of 2013.

On April 16, 2013, DXP acquired all of the stock of National Process Equipment Inc. ("NatPro") through its wholly owned subsidiary, DXP Canada Enterprises Ltd. DXP acquired this business to expand DXP's geographic presence in Canada and strengthen DXP's pump, integrated system packaging and related equipment offering. The \$40.1 million purchase price was financed with \$36.6 million of borrowings under our then-existing credit facility and 52,542 shares of DXP common stock. Additionally, the purchase agreement included an earn-out provision, which stated that former owners of NatPro may earn CDN \$6.0 million based on achievement of an earnings target during the first year of DXP's ownership. The fair value of the earn-out recorded at the acquisition date was \$2.8 million. As of December 31, 2013 the \$2.8 million accrued liability associated with this earn-out provision was reversed and included in 2013 operating income. See Note 8 of the financial statements regarding the 2014 impairment of NatPro assets.

On May 17, 2013, DXP acquired substantially all of the assets of Tucker Tool Company, Inc. ("Tucker Tool"). DXP acquired this business to expand DXP's geographic presence in the northern U.S. and strengthen DXP's industrial cutting tools offering. DXP paid approximately \$5.0 million for Tucker Tool which was borrowed under our then-existing credit facility.

On July 1, 2013, DXP acquired all of the stock of Alaska Pump & Supply, Inc. (APS). DXP acquired this business to expand DXP's geographic presence in Alaska. DXP paid approximately \$13.0 million for APS which was borrowed under our then-existing credit facility.

On July 31, 2013, DXP acquired substantially all of the assets of Tool-Tech Industrial Machine & Supply, Inc. ("Tool-Tech"). DXP acquired this business to enhance our metal working product offering in the southwest region of the United States. DXP paid approximately \$7.2 million for Tool-Tech which was borrowed under our then-existing credit facility.

On January 2, 2014, the Company acquired all of the equity securities and units of B27, LLC ("B27"). DXP acquired this business to expand DXP's pump packaging offering. The total transaction value was approximately \$304.9 million, including working capital payments and excluding approximately \$1.0 million in transaction costs. The purchase price was financed with borrowings under our then-existing credit facility and approximately \$4.0 million (36,000 shares) of DXP common stock. See Note 8 of the Notes to Consolidated Financial Statements regarding the 2014 and 2015 impairments of B27 goodwill. After the acquisition of B27, there was a working capital dispute between the Company and the sellers. During the third quarter of 2015, an accounting expert issued his report on the working capital dispute between DXP and the sellers of B27. The report required DXP to pay the sellers of B27 an additional \$11.3 million. Because the time period to allow adjustments of purchase accounting had expired, \$7.3 million of the payment was expensed. The remaining \$4.0 million of the required payment represented tax refunds,

which the Company collected as of the end of 2016.

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On May 1, 2014, the Company completed the acquisition of all of the equity interests of Machinery Tooling and Supply, LLC (MT&S) to expand DXP's cutting tools offering in the North Central region of the United States. DXP paid approximately \$14.7 million for MT&S, which was borrowed under our then-existing credit facility.

On April 1, 2015, the Company completed the acquisition of all of the equity interests of Tool Supply, Inc. ("TSI") to expand DXP's cutting tools offering in the Northwest region of the United States. DXP paid approximately \$5.0 million for TSI, which was borrowed under our then-existing credit Facility.

On September 1, 2015, the Company completed the acquisition of all of the equity interests of Cortech Engineering, LLC ("Cortech") to expand DXP's rotating equipment offering to the Western seaboard. DXP paid approximately \$14.9 million for Cortech. The purchase was financed with borrowings under our then-existing credit facility as well as \$4.4 million (148.8 thousand shares) of DXP common stock.

On January 1, 2018, the Company completed the acquisition of Application Specialties, Inc. ("ASI"), a distributor of cutting tools, abrasives, coolants and machine shop supplies. DXP paid approximately \$11.5 million for ASI. The purchase was financed with \$10.6 million of cash on hand as well as issuing \$0.9 million of DXP's common stock.

Disposition

On October 3, 2016, the Company sold Vertex Corporate Holdings, Inc. for approximately \$31 million in cash. The sale is a non-core business divestiture for DXP, and the proceeds were primarily used to pay down debt obligations.

Competition

Our business is highly competitive. In the Service Centers segment we compete with a variety of industrial supply distributors, some of which may have greater financial and other resources than we do. Some 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 variety of products and services as broad as our offerings. Further, while certain catalog distributors provide product offerings as broad as ours, these competitors do not offer the product application, technical expertise 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 expertise, responsiveness 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 \$250,000 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 decreased over the past three years in connection with the decline in revenues, payroll and vehicles since 2014. This trend would be expected to reverse with an increase in revenues. 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.

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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 including those established by the Occupational Safety and Health Administration and Canadian Occupational Health and Safety.

Certain of our operations are subject to federal, state and local laws and regulations as well as provincial 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, such laws and regulations could result in costs to remediate releases of regulated substances into the environment or costs to remediate sites to which we sent regulated substances for disposal. In some cases, these laws can impose strict liability for the entire cost of clean-up on any responsible party without regard to negligence or fault and impose liability on us for the conduct of others or conditions others have caused, or for our acts that complied with all applicable requirements when we performed them. New laws have been enacted and regulations are being adopted by various regulatory agencies on a continuing basis and the costs of compliance with these new laws can only be broadly appraised until their implementation becomes more defined.

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, 2017, DXP had approximately 2,511 employees, all of whom were full-time.

Background of Executive Officers

The following is a list of DXP's executive officers, their age, positions, and a description of each officer's business experience as of March 28, 2018. All of our executive officers hold office at the pleasure of DXP's Board of Directors.

NAME	POSITION	AGE
David R. Little	Chairman of the Board, President and Chief Executive Officer	66
Kent Yee	Senior Vice President/Chief Financial Officer	42
Mac McConnell	Senior Vice President/Finance, Chief Accounting Officer and Secretary*	64
David C. Vinson	Senior Vice President/Innovative Pumping Solutions	67
John J. Jeffery	Senior Vice President/Supply Chain Services	50
Todd Hamlin	Senior Vice President/Service Centers	46
Chris Gregory	Senior Vice President/Information Technology	43

* As previously disclosed, on March 16, 2018, Mac McConnell notified the Company of his intention to retire from his role with the Company effective March 31, 2018. The Company is in the process of conducting a search for a new Chief Accounting Officer.

David R. Little. Mr. Little has served as Chairman of the Board, President and Chief Executive Officer of DXP since its organization in 1996 and also has held these positions with SEPCO Industries, Inc., predecessor to the Company ("SEPCO"), since he acquired a controlling interest in SEPCO in 1986. Mr. Little has been employed by SEPCO since

1975 in various capacities, including Staff Accountant, Controller, Vice President/Finance and President. Mr. Little gives our Board insight and in-depth knowledge of our industry and our specific operations and strategies. He also provides leadership skills and knowledge of our local community and business environment, which he has gained through his long career with DXP and its predecessor companies.

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Kent Yee. Mr. Yee was appointed Senior Vice President/Chief Financial Officer in June 2017. Currently, Mr. Yee is responsible for acquisitions, finance, accounting and human resources of DXP. From March 2011 to June 2017, Mr. Yee served as Senior Vice President Corporate Development and led DXP's mergers and acquisitions, business integration and internal strategic project activities. During March 2011, Mr. Yee joined DXP from Stephens Inc.'s Industrial Distribution and Services team where he served in various positions and most recently as Vice President from August 2005 to February 2011. Prior to Stephens, Mr. Yee was a member of The Home Depot's Strategic Business Development Group with a primary focus on acquisition activity for HD Supply. Mr. Yee was also an Associate in the Global Syndicated Finance Group at JPMorgan Chase. He has executed over 43 transactions including more than \$1.4 billion in M&A and \$3.4 billion in financing transactions primarily for change of control deals and numerous industrial and distribution acquisition and sale assignments. He holds a Bachelors of Arts in Urban Planning from Morehouse College and an MBA from Harvard University Graduate School of Business.

Mac McConnell. Mr. McConnell transitioned from Senior Vice President/Finance and Chief Financial Officer to Senior Vice President/Finance and Chief Accounting Officer in June 2017. From September 2000 to June 2017, Mr. McConnell served as Senior Vice President/Finance and Chief Financial Officer. From February 1998 until September 2000, Mr. McConnell served as Senior Vice President, Chief Financial Officer and a director of Transportation Components, Inc., a NYSE-listed distributor of truck parts. From December 1992 to February 1998, he served as Chief Financial Officer of Sterling Electronics Corporation, a NYSE-listed electronics parts distributor, which was acquired by Marshall Industries, Inc. in 1998. From 1990 to 1992, Mr. McConnell was Vice President-Finance of Interpak Holdings, Inc., a publicly-traded company involved in packaging and warehousing thermoplastic resins. From 1976 to 1990, he served in various capacities, including as a partner, with Ernst & Young LLP.

David C. Vinson. Mr. Vinson was elected Senior Vice President/Innovative Pumping Solutions in January 2006. He served as Senior Vice President/Operations of DXP from October 2000 to December 2005. From 1996 until October 2000, Mr. Vinson served as Vice President/Traffic, Logistics and Inventory. Mr. Vinson has served in various capacities with DXP since his employment in 1981.

John J. Jeffery. Mr. Jeffery serves as Senior Vice President of Supply Chain Services, Marketing and Information Technology. He oversees the strategic direction for the Supply Chain Services business unit while leveraging both Marketing and Information Technology to drive innovative business development initiatives for organizational growth and visibility. He began his career with T.L. Walker, which was later acquired by DXP in 1991. During his tenure with DXP, Mr. Jeffery has served in various significant capacities including branch, area, regional and national sales management as well as sales, marketing and Service Center vice president roles. He holds a Bachelor of Science in Industrial Distribution from Texas A&M University and is also a graduate of the Executive Business Program at Rice University.

Todd Hamlin. Mr. Hamlin was elected Senior Vice President of DXP Service Centers in June of 2010. Mr. Hamlin joined the Company in 1995. From February 2006 until June 2010 he served as Regional Vice President of the Gulf Coast Region. Prior to serving as Regional Vice President of the Gulf Coast Region he served in various capacities, including application engineer, product specialist and sales representative. From April 2005 through February 2006, Mr. Hamlin worked as a sales manager for the UPS Supply Chain Services division of United Parcel Service, Inc. He holds a Bachelor's of Science in Industrial Distribution from Texas A&M University and a Master in Distribution from Texas A&M University. Mr. Hamlin serves on the Advisory Board for Texas A&M's Master in Distribution degree program. In 2014, Mr. Hamlin was elected to the Bearing Specialists Association's Board of Directors.

Chris Gregory. Mr. Gregory was elected Senior Vice President and Chief Information Officer in March of 2018. Mr. Gregory joined the Company in August 2006. From December 2014 until January 2018 he served as Vice President of IT Strategic Solutions. Prior to serving as Vice President of IT Strategic Solutions he served in various roles, including application developer, database manager as well as leading the business intelligence and application development departments. He holds a Bachelor of Business Administration and Computer Information Systems from

the University of Houston and an MBA from The University of Texas at Austin, McCombs School of Business.

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All officers of DXP hold office until the regular meeting of the board of directors following the Annual Meeting of Shareholders or until their respective successors are duly elected and qualified or their earlier resignation or removal.

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) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Additionally, we make the following available free of charge through our Internet website ir.dxpe.com:

- DXP Code of Ethics for Senior Financial Officers;
- DXP Code of Conduct;
- Compensation Committee Charter;
- Nominating and Governance Committee Charter; and
- Audit Committee Charter

ITEM 1A. Risk Factors

We are subject to various risks and uncertainties in the course of our business. Investing in DXP involves risk. In deciding whether to invest in DXP, you should carefully consider the risk factors below as well as those matters referenced in the foregoing pages under “Disclosure Regarding Forward-Looking Statements” and other information included and incorporated by reference into this Report and other reports and materials filed by us with the Securities and Exchange Commission. Any of these risk factors could have a significant or material adverse effect on our businesses, results of operations, financial condition or liquidity. They could also cause significant fluctuations and volatility in the trading price of our securities. Readers should not consider any descriptions of these factors to be a complete set of all potential risks that could affect DXP. Further, many of these risks are interrelated and could occur under similar business and economic conditions, and the occurrence of certain of them may in turn cause the emergence or exacerbate the effects of others. Such a combination could materially increase the severity of the impact of these risks on our results of operations, liquidity and financial condition.

Decreased capital expenditures in the energy industry can adversely impact our customers’ demand for our products and services.

A significant portion of our revenue depends upon the level of capital and operating expenditures in the oil and natural gas industry, including capital expenditures in connection with the upstream, midstream, and downstream phases in the energy industry. Therefore, a significant decline in oil or natural gas prices could lead to a decrease in our customers’ capital and other expenditures and could adversely affect our revenues.

Demand for our products could decrease if the manufacturers of those products sell them directly to end users.

Typically, MRO products have been purchased through distributors and not directly from the manufacturers of those products. If customers were to purchase our products directly from manufacturers, or if manufacturers sought to increase their efforts to sell directly to end users, we could experience a significant decrease in sales and earnings.

Changes in our customer and product mix, or adverse changes to the cost of goods we sell, could cause our gross margin percentage to fluctuate or decrease, and we may not be able to maintain historical margins.

Changes in our customer mix have resulted from geographic expansion, daily selling activities within current geographic markets, and targeted selling activities to new customers. Changes in our product mix have resulted from

marketing activities to existing customers and needs communicated to us from existing and prospective customers. There can be no assurance that we will be able to maintain our historical gross margins. In addition, we may also be subject to price increases from vendors that we may not be able to pass along to our customers.

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A deterioration in the oil and gas sector or other circumstances may negatively impact our business and results of operations and thus hinder our ability to comply with financial covenants under our credit facilities, including the Secured Leverage Ratio and Fixed Charge Coverage Ratio financial covenants.

A deterioration of the oil and gas sector or other circumstances that reduce our earnings may hinder our ability to comply with certain financial covenants under our credit facilities. Specifically, compliance with the Secured Leverage Ratio and Fixed Charge Coverage Ratio covenants depend on our ability to maintain net income and prevent losses. In the future we may not be able to comply with the covenants and, if we are not able to do so, our lenders may not be willing to waive such non-compliance or amend such covenants. If we are unable to comply with our financial covenants or obtain a waiver or amendment of those covenants or obtain alternative financing, our business and financial condition would be adversely affected.

We rely upon third-party transportation providers for our merchandise shipments and are subject to increased shipping costs as well as the potential inability of our third-party transportation providers to deliver products on a timely basis.

We rely upon independent third-party transportation providers for our merchandise shipments, including shipments to and from all of our service centers. Our utilization of these delivery services for shipments is subject to risks, including increases in fuel prices, labor availability, labor strikes and inclement weather, which may impact a shipping company's ability to provide delivery services that adequately meet our shipping needs. If we change the shipping companies we use, we could face logistical difficulties that could adversely affect deliveries and we would incur costs and expend resources in connection with such change. In addition, we may not be able to obtain favorable terms as we have with our current third-party transportation providers.

Adverse weather events or natural disasters could negatively disrupt our operations.

Certain areas in which we operate are susceptible to adverse weather conditions or natural disasters, such as hurricanes, tornadoes, floods and earthquakes. These events can disrupt our operations, result in damage to our properties and negatively affect the local economies in which we operate. Additionally, we may experience communication disruptions with our customers, vendors and employees.

We cannot predict whether or to what extent damage caused by these events will affect our operations or the economies in regions where we operate. These adverse events could result in disruption of our purchasing or distribution capabilities, interruption of our business that exceeds our insurance coverage, our inability to collect from customers and increased operating costs. Our business or results of operations may be adversely affected by these and other negative effects of these events.

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

The loss of the services of any of the executive officers of the 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. 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.

If we do not successfully remediate our internal controls weaknesses, our financial statements may not be accurate and the trading price of our stock could be negatively impacted.

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As discussed in Item 9A, “Managements Report on Internal Controls Over Financial Reporting,” we had material weaknesses in our internal controls during 2017. If we fail to successfully remediate those weaknesses, our financial statements may not be accurate and the trading price of our stock could be negatively impacted

We are subject to various government regulations.

We are subject to laws and regulations in every jurisdiction where we operate. Compliance with laws and regulations increases our cost of doing business. We are subject to a variety of laws and regulations, including without limitation import and export requirements, the Foreign Corrupt Practices Act, tax laws (including U.S. taxes on our foreign subsidiaries), data privacy requirements, labor laws and anti-competition regulations. We are also subject to audits and inquiries in the ordinary course of business. Changes to the legal and regulatory environments could increase the cost of doing business, and such costs may increase in the future as a result of changes in these laws and regulations or in their interpretation. Our employees, contractors or agents may violate laws and regulations despite our attempts to implement policies and procedures to comply with such laws and regulations. Any such violations could individually or in the aggregate materially adversely affect our financial condition or results of operations.

We are subject to environmental, health and safety laws and regulations.

We are subject to federal, state, local, foreign and provincial environmental, health and safety laws and regulations. Fines and penalties may be imposed for non-compliance with applicable environmental, health and safety requirements and the failure to have or to comply with the terms and conditions of required permits. The failure by us to comply with applicable environmental, health and safety requirements could result in fines, penalties, enforcement actions, third party claims for property damage and personal injury, requirements to clean up property or to pay for the costs of cleanup, or regulatory or judicial orders requiring corrective measures.

A general 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. We traditionally do not enter into long-term contracts with our customers which increases the likelihood that economic downturns would affect our business.

Risks Associated With Conducting Business in Foreign Countries

We conduct a meaningful amount of business outside of the United States of America. We could be adversely affected by economic, legal, political and regulatory developments in countries that we conduct business in. We have meaningful operations in Canada in which the functional currency is denominated in Canadian dollars. As the value of currencies in foreign countries in which we have operations increases or decreases related to the U.S. dollar, the sales, expenses, profits, losses assets and liabilities of our foreign operations, as reported in our Consolidated Financial Statements, increase or decrease, accordingly.

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 adversely affect our business.

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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. We may not be successful in efforts to increase sales and product offerings to existing customers. Consolidation in our industry could heighten the impacts of competition on our business and results of operations discussed above. The fact that we do not traditionally enter into long-term contracts with our suppliers or customers may provide opportunities for our competitors.

We are subject to personal injury and product liability claims involving allegedly defective products.

A variety of products we distribute are used in potentially hazardous applications that can result in personal injury and product liability claims. A catastrophic occurrence at a location where the products we distribute are used may result in us being named as a defendant in lawsuits asserting potentially large claims and applicable law may render us liable for damages without regard to negligence or fault.

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 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, difficulties in integrating operations, technologies, services and personnel of acquired companies, potential loss of customers of acquired companies, preserving business relationships of the acquired companies, 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 existing credit agreements or equity or debt financings. Our current credit agreements with lenders contain certain restrictions that could adversely affect our ability to implement and finance potential acquisitions. Such restrictions include provisions which limit our ability to merge or consolidate with, or acquire all or a substantial part of the properties or capital stock of, other entities without the prior written consent of the lenders. There can be no assurance that we will be able to obtain the lenders' 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.

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Ability to Comply with Financial Covenants of Credit Facilities

Our credit facilities require 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 facilities, which could permit acceleration of the Company's indebtedness under the credit facilities. The Company from time to time has been unable to comply with some of the financial covenants contained in previous credit facilities (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. In the future the Company may not be able to comply with the covenants or, if is not able to do so, that its lenders will be willing to waive such non-compliance or amend such covenants.

Ability to Refinance

We may not be able to refinance existing debt or the terms of any refinancing may not be as favorable as the terms of our existing debt. If principal payments due upon default or at maturity cannot be refinanced, extended or repaid with proceeds from other sources, such as new equity capital, our cash flow may not be sufficient to repay all maturing debt in years when significant payments come due.

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. Goodwill and intangibles represent a significant amount of our total assets. As of December 31, 2017, our combined goodwill and intangible assets amounted to \$266.1 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 which would directly impact earnings. We expect to record additional goodwill and other intangible assets as a result of future business acquisitions. 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. See Note 8 of the Notes to Consolidated Financial Statements regarding the 2015 impairments of B27 goodwill.

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.

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. Our information systems are vulnerable to natural disasters, power losses, telecommunication failures and other problems despite the protection of our information systems through physical and software safeguards and remote processing capabilities. 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.

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Risks Associated with Insurance

In the ordinary course of business we at times may become the subject of various claims, lawsuits or administrative proceedings seeking damages or other remedies concerning our commercial operations, the products we distribute, employees and other matters, including potential claims by individuals alleging exposure to hazardous materials as a result of the products we distribute or our operations. Some of these claims may relate to the activities of businesses that we have acquired, even though these activities may have occurred prior to acquisition. The products we distribute are subject to inherent risks that could result in personal injury, property damage, pollution, death or loss of production.

We maintain insurance to cover potential losses, and we are subject to various deductibles and caps under our insurance. It is possible, however, that judgments could be rendered against us in cases in which we would be uninsured and beyond the amounts that we currently have reserved or anticipate incurring for such matters. Even a partially uninsured claim, if successful and of significant size, could have a material adverse effect on our business, results of operations and financial condition. Furthermore, we may not be able to continue to obtain insurance on commercially reasonable terms in the future, and we may incur losses from interruption of our business that exceed our insurance coverage. In cases where we maintain insurance coverage, our insurers may raise various objections and exceptions to coverage which could make uncertain the timing and amount of any possible insurance recovery.

Risks Associated with Cyber-Security

Through our sales channels and electronic communications with customers generally, we collect and maintain confidential information that customers provide to us in order to purchase products or services. We also acquire and retain information about suppliers and employees in the normal course of business. Computer hackers may attempt to penetrate our information systems or our vendors' information systems and, if successful, misappropriate confidential customer, supplier, employee or other business information. In addition, one of our employees, contractors or other third party may attempt to circumvent security measures in order to obtain such information or inadvertently cause a breach involving such information. Loss of information could expose us to claims from customers, suppliers, financial institutions, regulators, payment card associations, employees and other persons, any of which could have an adverse effect on our financial condition and results of operations. We may not be able to adequately insure against cyber risks.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

We own 8 of our facilities, including our headquarters facility in Houston, Texas, which has approximately 48,000 square feet of office space. The remainder of our facilities are leased. At December 31, 2017, we had approximately 176 facilities which contained 161 services centers, 4 distribution centers and 11 fabrication facilities.

At December 31, 2017, the Service Centers segment operated out of 161 service center facilities. Of these facilities, 125 were located in the U.S. in 34 states, 34 were located in 9 Canadian provinces, one was located in Sonora, Mexico and one was located in Dubai. All of the distribution centers were located in the U.S., specifically in Montana, Nebraska, and Texas. At December 31, 2017, the Innovative Pumping Solutions segment operated out of 11 fabrication facilities located in 4 states in the U.S. and two provinces in Canada. At December 31, 2017, the Supply Chain Services segment operated supply chain installations in 67 of our customers' facilities in 25 U.S. states.

At December 31, 2017, our owned facilities ranged from 5,000 square feet to 48,000 square feet in size. We leased facilities for terms generally ranging from one to fifteen years. The leased facilities ranged from approximately 570 square feet to 105,000 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.

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ITEM 3. Legal Proceedings

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

ITEM 4. Mine Safety Disclosures

Not applicable.

PART II

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

Our common stock trades on The NASDAQ Global Select 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
2017		
Fourth Quarter	\$32.44	\$25.01
Third Quarter	\$35.62	\$25.35
Second Quarter	\$41.67	\$32.80
First Quarter	\$39.94	\$29.54
2016		
Fourth Quarter	\$37.88	\$19.75
Third Quarter	\$30.69	\$15.07
Second Quarter	\$22.94	\$12.78
First Quarter	\$21.91	\$13.31

On March 21, 2018, we had approximately registered 381 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 credit facilities limit our ability to declare or pay cash dividends or other distributions on our capital stock. 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's common stock to the NASDAQ Industrial Index and the NASDAQ Composite (US). The graph assumes that the value of the investment in DXP's common stock and in each index was \$100 at December 31, 2012 and that all dividends were reinvested.

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

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Equity Compensation Table

The following table provides information regarding shares covered by the Company's equity compensation plans as of December 31, 2017:

Plan category	Number of Securities to be issued upon 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	77,901	\$ 30.36	401,223	(1)
Equity compensation plans not approved by shareholders	N/A	N/A	N/A	N/A	N/A	
Total	N/A	N/A	77,901	\$ 30.36	401,223	(1)

(1) Represents shares of common stock authorized for issuance under the 2016 Omnibus Incentive Plan.

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Unregistered Shares

DXP issued 148,769 unregistered shares of DXP’s common stock as part of the consideration for the September 1, 2015 acquisition of Cortech. The unregistered shares were issued to the sellers of Cortech.

DXP issued 30,305 unregistered shares of DXP’s common stock as part of the consideration for the January 1, 2018 acquisition of ASI. The unregistered shares were issued to the sellers of ASI.

We relied on Section 4(a)(2) of the Securities Exchange Act as a basis for exemption from registration. All issuances were as a result of private negotiation, and not pursuant to public solicitation. In addition, we believe the shares were issued to “accredited investors” as defined by Rule 501 of the Securities Act.

Recent Sales of Common Stock

On August 19, 2016, the Company filed with the Securities and Exchange Commission a Form S-3 Registration Statement, commonly referred to as a “shelf registration,” which was effective August 26, 2016, whereby the Company registered shares of common stock and which shall have an aggregate offering price of up to \$100 million.

In September 2016, pursuant to this registration statement, the Company issued 238,858 shares of common stock at a weighted average price of \$26.38 per share under the related Equity Distribution Agreement. The distribution agents received \$0.1 million aggregate commissions on such sales. Net proceeds were approximately \$6.0 million. These proceeds were used to pay down debt obligations.

On October 31, 2016, the Company closed on the sale of 2,484,000 shares of stock for total net proceeds of \$46.2 million after expenses. These proceeds were used to pay down debt obligations.

Repurchases of Common Stock

During 2017, 2016 and 2015 the Company withheld 30,500, 12,507 and 20,440 shares, respectively, to satisfy tax withholding obligations in connection with vesting of employee equity awards.

On December 17, 2014, DXP publicly announced an authorization from the Board of Directors that allowed DXP from time to time to purchase up to 400,000 shares of DXP's common stock over 24 months. Purchases could be made in open market or in privately negotiated transactions. DXP purchased 191,420 shares for \$8.9 million under this authorization through December 31, 2015. No shares were purchased during 2016. The authorization expired on December 16, 2016.

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, 2017 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.

	2017	Years Ended December 31,			2013
		2016	2015 ⁽²⁾	2014 ⁽¹⁾	
		(in thousands, except per share amounts)			
Consolidated Statement of Earnings Data:					
Sales	\$1,006,782	\$962,092	\$ 1,247,043	\$ 1,499,662	\$1,241,510
Gross Profit	271,581	264,802	351,986	432,840	372,345

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Impairment expense	-	-	68,735	117,569	-
B27 settlement	-	-	7,348	-	-
Operating income (loss)	33,490	19,332	(27,916)	(12,628)	100,924
Income (loss) before income taxes	16,892	9,674	(38,920)	(25,556)	94,717
Net income (loss)	16,529	7,151	(39,070)	(45,238)	60,237
Net (loss) attributable to noncontrolling interest	(359)	(551)	(534)	-	-
Net income (loss) attributable to DXP Enterprises, Inc.	16,888	7,702	(38,536)	(45,328)	60,237
Per share amounts					
Basic earnings (loss) per common share ⁽³⁾	0.97	0.51	\$ (2.68)	\$ (3.10)	\$4.17
Common shares outstanding ⁽³⁾	17,400	15,042	14,423	14,639	14,439
Diluted earnings (loss) per share ⁽³⁾	0.93	0.49	\$ (2.68)	\$ (3.10)	\$3.94
Common and common equivalent shares Outstanding ⁽³⁾	18,240	15,882	14,423	14,639	15,279

(1)The impairment expense in 2014, further discussed in Note 8 of the Notes to Consolidated Financial Statements, reduced operating income by \$117.6 million, increased the net loss by \$102.0 million, and increased basic and diluted loss per share by \$6.97.

(2) The impairment expense in 2015, further discussed in Note 8 of the Notes to Consolidated Financial Statements, reduced operating income by \$68.7 million, increased the net loss by \$58.4 million, and increased basic and diluted loss per share by \$4.05.

(3) See Note 12 of the Notes to Consolidated Financial Statements for the calculation of basic and diluted earnings per share.

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Consolidated Balance Sheet Data:

	2017	2016	2015	2014	2013
Total assets	\$639,083	\$602,052	\$683,980	\$841,632	\$636,615
Long-term debt obligations	248,716	174,323	300,726	372,908	168,372
Shareholders' equity	268,546	252,549	198,870	242,952	296,250

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 within Item 8, Financial Statements and Supplementary Data and the other financial information found elsewhere in this Report. Management's Discussion and Analysis uses forward-looking statements that involve certain risks and uncertainties as described previously in our Disclosure Regarding Forward-Looking Statements and Item 1A. Risk Factors.

General Overview

Our products are marketed in the United States, Canada, Dubai and 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 Canada, and global and micro-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 driven by a variety of factors, 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 2013, the growth rate of the general economy slowed from 2012 and sales of metal working and bearing and power transmission products to manufacturers of oil field equipment declined. Our employee headcount increased by 13.8% primarily as a result of multiple acquisitions. Sales for the year ended December 31, 2013 increased \$144.4 million, or 13.2%, to \$1.2 billion from \$1.1 billion in 2012. Sales by businesses acquired in 2013 accounted for \$63.7 million of 2013 sales. Sales by businesses acquired in 2012 accounted for \$75.9 million of 2013 sales, on a same store sales basis. Excluding 2013 sales of \$139.6 million by businesses acquired in 2012 and 2013, on a same store sales basis, sales increased \$4.8 million, or 0.4%, from 2012.

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During 2014, the growth rate of the general economy increased slightly from 2013. However, oil prices declined significantly during the second half of 2014. Our employee headcount increased 15.5% primarily as a result of the two acquisitions completed during the year. Sales for the year ended December 31, 2014 increased \$258.2 million, or 20.8%, to approximately \$1,499.7 million from \$1,241.5 million in 2013. Sales by businesses acquired in 2014 accounted for \$176.4 million of 2014 sales. Sales by businesses acquired in 2013 accounted for \$35.1 million of the 2014 increase, on a same store sales basis. Excluding 2014 sales of \$211.5 million by businesses acquired in 2014 and 2013, on a same store sales basis, sales increased by \$46.7 million, or 3.8%, from 2013. This sales increase is primarily the result of increased sales by the Service Centers segment of \$22.1 million, IPS segment of \$8.1 million, and SCS segment of \$16.5 million, on a same store sales basis. The majority of these 2014 sales increases came from a broad based increase in sales of pumps, bearings, industrial supplies, metal working and safety products to customers engaged in oilfield service, oil and gas exploration and production, mining, manufacturing and petrochemical processing.

During 2015, the growth rate of the general economy was flat with 2014. However, the growth rate of the industrial economy slowed. Oil prices significantly declined during the year, falling approximately 35%. Our employee headcount decreased 12.7%, despite two acquisitions, primarily as a result of headcount reductions stemming from reduced capital spending by oil and gas producers. Sales for the year ended December 31, 2015 decreased \$252.6 million, or 16.9%, to approximately \$1,247.0 million from \$1,499.7 million in 2014. Sales by businesses acquired in 2014 and 2015 reduced the decline by \$14.5 million and \$9.1 million, respectively. Excluding 2015 sales of \$23.6 million by businesses acquired in 2014 and 2015, on a same store sales basis, sales decreased by \$276.2 million, or 18.4%, from 2014. This sales decrease is primarily the result of decreased sales by the Service Centers segment of \$184.6 million and IPS segment of \$93.3 million, which were partially offset by increased sales by the Supply Chain Services segment of \$1.7 million, on a same store sales basis. The majority of these 2015 sales decreases resulted from declines in sales of rotating equipment, bearings, metal working products, industrial supplies and safety products and services to customers engaged in oil and gas production, mining and manufacturing. The sales declines were primarily the result of reduced capital spending by oil and gas producers.

During 2016, the growth rate of the general economy remained flat with 2015 and the rig count declined significantly during the first half of 2016, increased during the second half, but remained significantly below 2014 peaks. The energy market for our products remained depressed. We reduced our employee headcount 24.1% due to the continued reduction of spending by the oil and gas producers. Sales for the year ended December 31, 2016 decreased \$285.0 million, or 22.9%, to approximately \$962.1 million from \$1,247.0 million in 2015. Sales by businesses acquired in 2015 accounted for \$15.1 million of 2016 sales. Sales by a business sold in 2016 accounted for a decline of \$7.1 million on a same store basis. Excluding 2016 sales of \$15.1 million by businesses acquired in 2015; and 2015 sales of \$7.1 million of the business divestiture in 2016, on a same store sales basis, sales decreased by \$292.9 million, or 23.6%, from 2015. This sales decrease is the result of decreased sales by the Service Centers segment of \$213.5 million, the IPS segment of \$67.7 million and the Supply Chain Services segment of \$11.7 million, on a same store sales basis. The majority of the 2016 sales decline is the result of a decrease in sales of pumps, bearings, industrial supplies, metal working and safety products to customers engaged in oilfield service, oil and gas exploration and production, mining, manufacturing and petrochemical processing.

During 2017, the growth rate of the general economy improved from 2016 and the rig count increased, but remained significantly below 2014 peaks. The energy market for our products improved. Sales for the year ended December 31, 2017 increased \$44.7 million, or 4.6%, to approximately \$1.0 billion from \$962.1 million for the prior corresponding period. Sales from a business sold in 2016 accounted for \$22.7 million of 2016 sales. Excluding the 2016 sales of the sold business, on a same store sales basis, sales for 2017 increased by \$67.4 million, or 7.2% from the prior corresponding period. This same store sales increase is the result of sales increases in our Service Centers, IPS and SCS segments of \$42.9 million, \$16.9 million and \$7.5 million respectively. The majority of the 2017 sales increase is the result of increased sales of pumps, bearings, industrial supplies, metal working and safety services 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 reach 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.

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Our strategies to increase productivity include consolidated purchasing programs, centralizing product distribution, customer service and inside sales functions, and using information technology to increase employee productivity.

Results of Operations

	Years Ended December 31,					
	2017	%	2016	%	2015	%
	(in millions, except percentages and per share amounts)					
Sales	\$ 1,006.8	100.0	\$ 962.1	100.0	\$ 1,247.0	100.0
Cost of sales	735.2	73.0	697.3	72.5	895.1	71.8
Gross profit	271.6	27.0	264.8	27.5	351.9	28.2
Selling, general & administrative expense	238.1	23.7	245.5	25.5	303.8	24.4
Impairment expense	-	-	-	-	68.7	5.5
B27 settlement	-	-	-	-	7.3	0.6
Operating income (loss)	33.5	3.3	19.3	2.0	(27.9)	(2.2)
Interest expense	17.1	1.7	15.5	1.6	10.9	0.9
Other expense (income)	(0.5)	-	(5.9)	(0.6)	0.1	-
Income (loss) before income taxes	16.9	1.6	9.7	1.0	(38.9)	(3.1)
Provision for income taxes	0.4	-	2.5	0.3	0.1	-
Net income (loss)	16.5	1.7	7.2	0.7	(39.0)	(3.1)
Net (loss) attributable to noncontrolling interest	(0.4)	-	(0.5)	-	(0.5)	-
Net income (loss) attributable to DXP Enterprises, Inc.	\$ 16.9	1.7	\$ 7.7	0.8	\$ (38.5)	(3.1)
Per share						
Basic earnings (loss) per share	\$ 0.97		\$ 0.51		\$ (2.68)	
Diluted earnings (loss) per share	\$ 0.93		\$ 0.49		\$ (2.68)	

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

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Results of operations for the Service Centers segment are as follows:

	2017	%	2016	%	2015	%
	(in millions, except percentages and per share amounts)					
Sales	\$ 641.3	100.0	\$ 621.0	100.0	\$ 826.6	100.0
Cost of sales	451.2	70.3	437.6	70.5	575.0	69.6
Gross profit	190.1	29.7	183.4	29.5	251.6	30.4
Selling, general & administrative expense	126.9	19.8	135.8	21.9	173.4	21.0
Impairment expense	-	-	-	-	15.8	1.9
Operating income (loss), excluding amortization	\$ 63.2	9.9	\$ 47.6	7.6	\$ 62.4	7.5
Operating income, excluding impairment and amortization	\$ 63.2	9.9	\$ 47.6	7.6	\$ 78.2	9.5

Results of operations for the IPS segment are as follows:

	2017	%	2016	%	2015	%
	(in millions, except percentages and per share amounts)					
Sales	\$ 204.0	100.0	\$ 187.1	100.0	\$ 254.8	100.0
Cost of sales	160.2	78.5	142.5	76.2	191.6	75.2
Gross profit	43.8	21.5	44.6	23.8	63.2	24.8
Selling, general & administrative expense	32.4	15.9	34.7	18.5	41.6	16.3
Impairment expense	-	-	-	-	52.9	20.8
Operating income (loss), excluding amortization	\$ 11.4	5.6	\$ 9.9	5.3	\$ (31.3)	(12.3)
Operating income excluding impairment and amortization	\$ 11.4	5.6	\$ 9.9	5.3	\$ 21.6	8.5

Results of operations for the SCS segment are as follows:

	2017	%	2016	%	2015	%
	(in millions, except percentages and per share amounts)					
Sales	\$ 161.5	100.0	\$ 154.0	100.0	\$ 165.6	100.0
Cost of sales	123.8	76.7	117.1	76.1	128.4	77.5
Gross profit	37.7	23.3	36.9	23.9	37.2	22.5
Selling, general & administrative expense	22.2	13.7	21.5	13.9	23.0	13.9
Operating income (loss), excluding amortization	\$ 15.5	9.6	\$ 15.4	10.0	\$ 14.2	8.6

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Year Ended December 31, 2017 compared to Year Ended December 31, 2016

SALES. Sales for the year ended December 31, 2017 increased \$44.7 million, or 4.6%, to approximately \$1.0 billion from \$962.1 million for the year ended December 31, 2016. Sales from a business sold in 2016 accounted for \$22.7 million of 2016 sales. Excluding the 2016 sales of the sold business, on a same store sales basis, sales for 2017 increased by \$67.4 million, or 7.2% from 2016. This same store sales increase is the result of an increase in our Service Centers, IPS and SCS segments of \$42.9 million, \$16.9 million and \$7.5 million respectively. These fluctuations in the sales in our segments are further explained in segment discussions below.

GROSS PROFIT. Gross profit as a percentage of sales for the year ended December 31, 2017 decreased by approximately 55 basis points from the year ended December 31, 2016. On a same store sales basis, gross profit as a percentage of sales decreased by approximately 25 basis points. The overall decrease in the profit percentage, on a same store sales basis, is the result of an approximate 235 basis point decrease in the gross profit percentage in our IPS segment and an approximate 61 basis point decrease in gross profit percentage in our Supply Chain Services segment partially offset by an approximate 51 basis point increase in the gross profit percentage in our Service Centers segment. These fluctuations are explained in the segment discussions below.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative expense (SG&A) for the year ended December 31, 2017 decreased by approximately \$7.4 million, or 3.0%, to \$238.1 million from \$245.5 million for the year ended December 31, 2016. SG&A from a business that was sold accounted for \$6.1 million of the decrease. Excluding the 2016 SG&A from the business that was sold in 2016, on a same store sales basis, SG&A decreased by \$1.3 million, or 1.0%. The overall decline in SG&A, on a same store sales basis, is the result of decreased payroll, related taxes and 401(k) expenses due to headcount and salary reductions and other cost reduction measures primarily implemented near the end of the first quarter of 2016. Additionally, amortization expense declined by \$0.8 million, on a same store sales basis. As a percentage of sales, the 2017 expense decreased approximately 183 basis points to 23.7% from 25.5% for 2016, on a same store sales basis.

OPERATING INCOME. Operating income for the year ended December 31, 2017 increased \$14.2 million, to \$33.5 million, from \$19.3 million in the year ended December 31, 2016. The operating income from the business sold in 2016 reduced the overall increase during 2017 in operating income in the amount of \$2.9 million. Excluding the operating income from the business sold, on a same store sales basis, operating income increased \$17.1 million, or 103.8% from 2016. This increase in operating income is primarily related to the increase in gross profit and decrease in SG&A discussed above.

INTEREST EXPENSE. Interest expense for the year ended December 31, 2017 increased 9.6% from the year ended December 31, 2016 primarily as a result of increased interest rates under our credit facilities.

INCOME TAXES. Our effective tax rate from continuing operations was a tax expense of 2.2% for the year ended December 31, 2017 compared to a tax expense of 26.1% for the year ended December 31, 2016. Compared to the U.S. statutory rate for the year ended December 31, 2017, the effective tax rate was increased by state taxes and nondeductible expenses. The effective tax rate decreased because of the remeasurement of our net deferred income tax liabilities, lower income tax rates on income earned in foreign jurisdictions, the change in valuation allowance recorded against deferred tax assets, the reduction of tax rates used to establish deferred tax liabilities related to intangibles for customer relationships acquired in Canada in 2012 and 2013, research and development tax credits and domestic production activity deduction. Compared to the U.S. statutory rate for the year ended December 31, 2016, the effective tax rate was increased by state taxes and nondeductible expenses. The effective tax rate decreased by the book gain on the sale of Vertex, lower income tax rates on income earned in foreign jurisdictions, research and development credits, and foreign tax credits.

SERVICE CENTERS SEGMENT. Sales for the Service Centers segment increased by \$20.3 million, or 3.3% for the year ended December 31, 2017 compared to the year ended December 31, 2016. Excluding \$22.7 million of the 2016 Service Centers segment sales from a business sold in 2016, Service Centers segment sales for 2017 increased \$42.9 million, or 7.2% from the year ended December 31, 2016, on a same store sales basis. This sales increase is primarily the result of increased sales of safety services and rotating equipment to customers engaged in the upstream, midstream or downstream oil and gas markets or manufacturing equipment for the upstream, midstream or downstream oil and gas markets in connection with increased capital spending by oil and gas producers and related businesses during 2017 compared to 2016. As a percentage of sales, the 2017 gross profit percentage for the Service Centers increased approximately 12 basis points but increased approximately 51 basis points on a same store sales basis, from 2016. This increase in the gross profit percentage is primarily the result of improved margins on sales of rotating equipment, bearings and industrial supplies. Operating income for the Service Centers segment increased \$18.5 million, or 41.4% on a same store sales basis. The increase in operating income is primarily the result of the reduced SG&A combined with increased gross profit.

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INNOVATIVE PUMPING SOLUTIONS SEGMENT. Sales for the IPS segment increased by \$16.9 million, or 9.0% for the year ended December 31, 2017 compared to the year ended December 31, 2016. This increase is primarily the result of increased capital spending by oil and gas producers and related businesses during 2017 compared to 2016. As a percentage of sales, 2017 gross profit percentage for the IPS segment decreased approximately 235 basis points from 2016 primarily as a result competitive pricing pressures and a reduced level of large, complex, high margin orders in 2017. Additionally, gross profit margins for individual orders for the IPS segment can fluctuate significantly because each order is for a unique package built to customer specifications and subject to varying competition. Operating income for the IPS segment increased \$1.6 million, or 15.8%, primarily as a result of the \$16.9 million increase in sales discussed above and a decrease of \$2.3 million in SG&A.

SUPPLY CHAIN SERVICES SEGMENT. Sales for the SCS segment increased by \$7.5 million, or 4.9%, for the year ended December 31, 2017 compared to the year ended December 31, 2016. The increase in sales is primarily related to increased sales to customers in the oil and gas industries. We suspect customers in the oilfield services and oilfield equipment manufacturing industries purchased more from DXP because of the increase in capital spending by oil and gas companies operating in the U.S and Canada. Gross profit as a percentage of sales decreased approximately 61 basis points in 2017 compared to 2016 primarily as a result of increased sales of lower margin products to oil and gas related customers. Operating income for 2017 was flat compared to 2016 for the SCS segment because gross profit increased \$0.8 million, which was partially offset by an increase of \$0.8 million in SG&A.

Year Ended December 31, 2016 compared to Year Ended December 31, 2015

SALES. Sales for the year ended December 31, 2016 decreased \$285.0 million, or 22.9%, to approximately \$962.1 million from \$1,247.0 million in 2015. Sales by businesses acquired in 2015 accounted for \$15.1 million of 2016 sales. Sales by a business sold in 2016 accounted for a decline of \$7.1 million of sales on a same store basis. Excluding 2016 sales of \$15.1 million by businesses acquired in 2015 and 2015 sales of \$7.1 million of the business sold in 2016, on a same store sales basis, sales decreased by \$292.9 million, or 23.6%, from 2015. This sales decline is the result of decreased sales by all three segments including \$213.5 million in Service Centers, \$67.7 million in IPS and \$11.7 million in SCS, on a same store sales basis. These decreases are explained in the segment discussions below.

GROSS PROFIT. Gross profit as a percentage of sales decreased approximately 70 basis points to 27.5% for 2016 compared to 28.2% for 2015. On a same store sales basis, gross profit as a percentage of sales decreased by approximately 60 basis points. This decline is primarily the result of an approximate 100 basis point decline in the 2016 gross profit percentage for our IPS segment and an approximate 80 basis point decline in our Service Centers segment, which was partially offset by an increase of approximately 145 basis points for the SCS segment. Gross profit as a percentage of sales for each segment are explained below.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE. Selling, general and administrative (or “SG&A”) expense for 2016 decreased by approximately \$58.3 million, or 19.21%, when compared to 2015. Selling, general and administrative expense by businesses acquired in 2015 was \$5.2 million on a same store basis. The 2015 SG&A expense for the 2016 business divestiture was \$2.1 million on a same store sales basis. Excluding 2016 expenses of \$5.2 million by businesses acquired in 2015 and 2015 expenses of \$2.1 million for the 2016 business divestiture, on a same store sales basis, selling, general and administrative expenses decreased by \$61.4 million, or 20.4%. The decline in SG&A, on a same store sales basis, is partially the result of a \$39.0 million decrease in payroll, variable compensation, payroll taxes and 401(k) expense due to headcount reductions. Amortization expense for 2016 decreased by \$2.6 million compared to 2015.

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OPERATING INCOME. Operating income for 2016 decreased approximately \$28.8 million, or 59.9%, from \$48.2 million to \$19.3 million, compared to 2015, excluding the 2015 impairment expense and B27 settlement,. Businesses acquired in 2015 increased the decline by \$0.6 million, on a same store sales basis, and the business divested reduced the decline by \$1.2 million. Excluding operating income from businesses acquired and divested, the B27 settlement and impairment expense, operating income decreased \$27.1 million or 57.6%. This decrease in operating income, on a same store sales basis, is primarily related to the decreased gross profit which is partially offset by the decline in SG&A discussed above.

INTEREST EXPENSE. Interest expense for 2016 increased by \$4.6 million, or 42.4%, from 2015 primarily due to an increase in our interest rates.

INCOME TAXES. Our 2016 provision for income taxes, which is at an effective rate of 26.1%, differed from the U.S. statutory rate of 35% primarily due to the effect of the book gain, but tax loss, recognized on the sale of Vertex during 2016. Our effective tax rate for 2016 of 62.4%, after excluding the effect of the sale of Vertex, increased from 27.7% for the prior corresponding period, before the effect of the mostly non-deductible impairment of goodwill and B27 settlement, primarily as a result of reduced research and development and foreign tax credits, reduced domestic production activity deductions and prior year provision to return adjustments. During 2009, DXP wrote off \$38.2 million of goodwill and intangibles in connection with an impairment which substantially reduced the book basis of Vertex, but not the tax basis.

SERVICE CENTERS SEGMENT. Sales for the Service Centers decreased \$205.6 million, or 24.9%, in 2016 compared to 2015. Sales by businesses acquired in 2015 accounted for \$15.1 million of 2016 sales. Sales by the 2016 business divestiture accounted for a decline of \$7.1 million on a same store basis. Excluding 2016 sales of \$15.1 million by businesses acquired in 2015 and \$7.1 million of 2015 sales for the 2016 divested business, on a same stores sales basis, Service Centers' sales decreased \$213.5 million, or 26.1%, on a same stores sales basis, from the prior corresponding period. The majority of the 2016 sales decrease is the result of decreased sales of rotating equipment, bearings, metal working products, industrial supplies and safety products and services to customers engaged in the upstream oil and gas market or manufacturing equipment for the upstream oil and gas market. If crude oil and natural gas prices were to return to, or go below the prices experienced during the first nine months of 2016, this level of sales to the upstream oil and gas industry would be expected to continue, or decline, during 2017. Gross profit as a percentage of sales, on a same store sales basis, declined approximately 80 basis points in 2016 compared to 2015 as a result of declines in the gross profit percentages for sales of pumps, safety services and metal working products due to competitive pressures. Excluding year-to-date Service Centers segment operating income from acquired businesses of \$0.4 million and \$1.2 million of 2015 income for the business divestiture, Service Centers segment operating income for 2016 decreased by \$29.7 million, or 38.6%, primarily as a result of the decline in sales discussed above and the percentage decrease in sales exceeding the percentage decrease in SG&A.

SUPPLY CHAIN SERVICES SEGMENT. Sales for Supply Chain Services decreased by \$11.7 million, or 7.0%, in 2016 compared to 2015. None of the 2015 acquisitions or the 2016 divestiture contributed sales to this segment. The decrease is primarily related to decreased sales to customers engaged in the oilfield services and oilfield manufacturing industries. We suspect customers in the oilfield services and oilfield equipment manufacturing industries purchased less from DXP because of the decline in the number of drilling rigs operating in the U.S and Canada. Gross profit as a percentage of sales increased approximately 145 basis points in 2016 compared to the prior corresponding period as a result of decreased sales of lower margin products to oil and gas and trucking related customers. Operating income for the SCS segment increased \$1.2 million, or 8.7%, primarily as a result of the 145 basis point increase in gross profit as a percentage of sales combined with a 7.0% reduction in SG&A.

INNOVATIVE PUMPING SOLUTIONS SEGMENT. Sales for Innovative Pumping Solutions decreased by \$67.7 million, or 26.6%, in 2016 compared to 2015. The sales decrease primarily resulted from a significant decline in capital spending by our oil and gas producers and related businesses stemming from the decline in the price of oil. If

crude oil and natural gas prices were to return to, or go below prices experienced during the first nine months of 2016, this level of sales to the upstream and mid-stream oil and gas industry would be expected to continue, or decline, during 2017. Gross profit as a percentage of sales declined approximately 100 basis points in 2016 compared to 2015 primarily as a result of competitive pressures resulting in lower margin jobs and \$3.7 million of unabsorbed manufacturing overhead related to the start-up of manufacturing our ANSI pumps. Additionally, gross profit margins for individual orders for the IPS segment can fluctuate significantly because each order is for a unique package built to customer specifications and subject to varying competition. Operating income decreased \$11.7 million, or 54.3%, primarily as a result of the 26.6% decline in sales and approximate 100 basis point decline in the gross profit percentage discussed above.

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Pro Forma Results

The pro forma unaudited results of operations for the Company on a consolidated basis for the twelve months ended December 31, 2017 and 2016, assuming the divestiture of a business completed in 2016 (previously discussed in Item 1, Business) was consummated as of January 1, 2016 are as follows (in millions, except per share amounts):

	Years Ended	
	December 31,	
	2017	2016
Net sales	\$1,006.8	\$939.4
Net income attributable to DXP Enterprises, Inc.	\$16.9	\$5.5
Per share data		
Basic earnings	\$0.97	\$0.36
Diluted earnings	\$0.93	\$0.35

The pro forma unaudited results of operations for the Company on a consolidated basis for the twelve months ended December 31, 2016 and 2015, assuming the acquisition of businesses completed in 2015 and divestiture of a business completed in 2016 (previously discussed in Item 1, Business) were consummated as of January 1, 2015 are as follows (in millions, except per share amounts).

	Years Ended	
	December 31,	
	2016	2015
Net sales	\$939.4	\$1,228.9
Net income (loss) attributable to DXP Enterprises, Inc.	\$5.5	\$(40.7)
Per share data		
Basic earnings (loss)	\$0.36	\$(2.83)
Diluted earnings (loss)	\$0.35	\$(2.83)

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, warehouse equipment, metal working equipment and capital expenditures for our safety products and services category. We also require cash to pay our lease obligations and to service our debt.

We generated approximately \$12.5 million of cash in operating activities in 2017 as compared to generating \$48.2 million in 2016. The decrease between the two periods was primarily driven by a \$20.5 million increase in accounts receivable in 2017 compared to a \$12.1 million reduction in 2016. The increase in accounts receivable resulted from the \$43.3 million increase in sales for the fourth quarter ended December 31, 2017 compared to the fourth quarter ended December 31, 2016. Sales for the fourth quarter of 2016 declined \$56.4 million compared to sales for the fourth quarter of 2015.

We purchased approximately \$2.8 million of capital assets during 2017 compared to \$4.9 million for 2016. Capital expenditures during 2017 were primarily related to building improvements, manufacturing equipment, and patterns. Capital expenditures for 2018 are expected to be within the range of capital expenditures during 2017 and 2016.

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At December 31, 2017, our total long-term debt, including the current portion, less principal repayments and less unamortized debt issuance fees, was \$242.0 million, or 47.4% of total capitalization (total long-term debt including current portion plus shareholders' equity) of \$510.6 million. Approximately \$249.4 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 \$5.0 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 2017, the amount available to be borrowed under our credit facilities increased from \$37.3 million at December 31, 2016, to \$82.0 million at December 31, 2017. This increase in availability is primarily a result of the Company terminating its previously existing credit facility and replacing it with the ABL Credit Agreement and Term Loan, as discussed further below.

Senior Secured Term Loan B and ABL Facility

On August 29, 2017, DXP entered into a five year, \$85 million Asset Based Loan and Security Agreement (the "ABL Credit Agreement") and a six-year, \$250 million Senior Secured Term Loan B (the "Term Loan B Agreement"), which replaced DXP's previously existing credit facility.

The ABL Credit Agreement provides for asset-based revolving loans in an aggregate principal amount of up to \$85.0 million (the "ABL Loans"). The ABL Credit Agreement may be increased in increments of \$10.0 million up to an aggregate of \$50.0 million. The facility will mature on August 29, 2022. Interest accrues on outstanding borrowings at a rate equal to LIBOR or CDOR plus a margin ranging from 1.25% to 1.75% per annum, or at an alternate base rate, Canadian prime rate or Canadian base rate plus a margin ranging from 0.25% to 0.75% per annum, in each case, based upon the average daily excess availability under the facility for the most recently completed calendar quarter. Fees ranging from 0.25% to 0.375% per annum are payable on the portion of the facility not in use at any given time. The unused line fee was 0.375% at December 31, 2017.

The interest rate for the ABL facility was 2.9% at December 31, 2017.

The Term Loan B Agreement provides for a \$250 million term loan (the "Term Loan") that amortizes in equal quarterly installments of 0.25% with the balance payable in August 2023, when the facility matures. Subject to securing additional lender commitments, the Term Loan B Agreement allows for incremental increases in facility size up to an aggregate of \$30 million, plus an additional amount such that DXP's Secured Leverage Ratio (as defined in the Term Loan B Agreement) would not exceed 3.60 to 1.00. Interest accrues on the Term Loan at a rate equal to the base rate plus a margin of 4.5% for the Base Rate Loans (as defined in the Term Loan B Agreement), or LIBOR plus a margin of 5.5% for the Eurodollar Rate Loans (as defined in the Term Loan B Agreement). We are required to repay the Term Loan with certain asset sales and insurance proceeds, certain debt proceeds and 50% of excess cash flow, reducing to 25%, if our total leverage ratio is no more than 3.00 to 1.00 and 0%, if our total leverage ratio is no more than 2.50 to 1.00.

The interest rate for the Term Loan was 7.1% as of December 31, 2017.

DXP's principal financial covenants under the ABL Credit Agreement and Term Loan B Agreement include:

Fixed Charge Coverage Ratio – The Fixed Charge Coverage Ratio under the ABL Credit Agreement is defined as the ratio for the most recently completed four-fiscal quarter period, of (a) EBITDA minus capital expenditures (excluding those financed or funded with debt (other than the ABL Loans), (ii) the portion thereof funded with the net proceeds from asset dispositions of equipment or real property which DXP is permitted to reinvest pursuant to the Term Loan and the portion thereof funded with the net proceeds of casualty insurance or condemnation awards in respect of any equipment and real estate which DXP is not required to use to prepay the ABL Loans pursuant to the Term Loan B Agreement or with the proceeds of casualty insurance or condemnation awards in respect of any other property) minus cash taxes paid (net of cash tax refunds received during such period), to (b) fixed charges. The Company is restricted from allowing its fixed charge coverage ratio be less than 1.00 to 1.00 during a compliance period, which is triggered when the availability under the ABL facility falls below a threshold set forth in the ABL Credit Agreement.

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As of December 31, 2017, the Company's consolidated Fixed Charge Coverage Ratio was 3.67 to 1.00.

Secured Leverage Ratio – The Term Loan B Agreement requires that the Company's Secured Leverage Ratio, defined as the ratio, as of the last day of any fiscal quarter of consolidated secured debt (net of unrestricted cash, not to exceed \$30 million) as of such day to EBITDA, beginning with the fiscal quarter ending December 31, 2017, is either equal to or less than as indicated in the table below:

Fiscal Quarter	Secured Leverage Ratio
December 31, 2017	5.75:1.00
March 31, 2018	5.75:1.00
June 30, 2018	5.50:1.00
September 30, 2018	5.50:1.00
December 31, 2018	5.25:1.00
March 31, 2019	5.25:1.00
June 30, 2019	5.00:1.00
September 30, 2019	5.00:1.00
December 31, 2019	4.75:1.00
March 31, 2020	4.75:1.00
June 30, 2020 and each Fiscal Quarter thereafter	4.50:1.00

EBITDA as defined under the Term Loan B Agreement for financial covenant purposes means, without duplication, for any period of determination, the sum of, consolidated net income during such period; plus to the extent deducted from consolidated net income in such period: (i) income tax expense, (ii) franchise tax expense, (iii) consolidated interest expense, (iv) amortization and depreciation during such period, (v) all non-cash charges and adjustments, and (vi) non-recurring cash expenses related to the Term Loan, provided, that if the Company acquires or disposes of any property during such period (other than under certain exceptions specified in the Term Loan B Agreement, including the sale of inventory in the ordinary course of business, then EBITDA shall be calculated, after giving pro forma effect to such acquisition or disposition, as if such acquisition or disposition had occurred on the first day of such period.

As of December 31, 2017, the Company's consolidated Secured Leverage Ratio was 3.59 to 1.00.

The ABL Loans and the Term Loan are secured by substantially all of the assets of the Company.

Borrowings (in thousands):

	December		
	31, 2017	December 31, 2016	Increase (Decrease)
Current portion of long-term debt	\$3,381	\$ 51,354	\$ (47,973)
Long-term debt, less debt issuance costs	238,643	173,331	65,312
Total long-term debt	\$242,024	\$ 224,685	\$ 17,339
Amount available ⁽¹⁾	\$82,007	\$ 37,347	\$ 44,660

(1) Represents the amount available to be borrowed at the indicated date under the most restrictive covenant of the credit facility in effect at the indicated date. The increase in the amount available to be borrowed is primarily the result of the Company terminating its previously existing credit facility and replacing it with the Term Loan B Agreement and the ABL Credit Agreement.

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Performance Metrics (in days):

	Three Months Ended December 31,		Increase (Decrease)
	2017	2016	
Days of sales outstanding	60.7	65.0	(4.3)
Inventory turns	8.4	7.7	0.7

Accounts receivable days of sales outstanding were 60.7 days at December 31, 2017 compared to 65.0 days at December 31, 2016. The 4.3 days decrease was primarily due to more timely payment times in connection with an improved economy. Inventory turns increased primarily due to stronger sales for the three months ended December 31, 2017 compared to sales for the three months ended December 31, 2016.

	Three Months Ended December 31,		Increase (Decrease)
	2016	2015	
Days of sales outstanding	65.0	56.9	8.1
Inventory turns	7.7	7.7	-

Accounts receivable days of sales outstanding were 65.0 days at December 31, 2016 compared to 56.9 days at December 31, 2015. The 8.1 days increase was primarily due to slower payment times by oil and gas customers. Inventory turns remained flat at December 31, 2016 compared to December 31, 2015.

Funding Commitments

We believe our cash generated from operations will meet our normal working capital needs during the next twelve months. However, we may require additional debt outside of our credit facilities or equity financing to fund potential acquisitions. Such additional financings may include additional bank debt or the public or private sale of debt or equity securities. In connection with any such financing, we may issue securities that substantially dilute the interests of our shareholders.

Repurchases of Common Stock

On December 17, 2014, DXP publicly announced an authorization from the Board of Directors that allowed DXP from time to time to purchase up to 400,000 shares of DXP's common stock over 24 months. Purchases could be made in open market or in privately negotiated transactions. DXP purchased 191,420 shares for \$8.9 million under this authorization through December 31, 2015. No shares were purchased during 2016. The authorization expired on December 16, 2016.

Contractual Obligations

The impact that our contractual obligations as of December 31, 2017 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

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	Payments Due by Period				Total
	Less than 1 Year	1–3 Years	3-5 Years	More than 5 Years	
Long-term debt, including current portion ⁽¹⁾	\$3,381	\$6,841	\$5,000	\$236,875	\$252,097
Operating lease obligations	19,419	26,494	16,072	3,441	65,426
Estimated interest payments ⁽²⁾	17,607	34,611	33,870	8,382	94,470
Total	\$40,407	\$67,946	\$54,942	\$248,698	\$411,993

(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, 2017. Assumes debt is paid on maturity date and not replaced.

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, 2017, we were not involved in any unconsolidated SPE transactions.

The Company has not made any guarantees to customers or vendors nor does the Company have any off-balance sheet arrangements or commitments, that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, change in financial condition, revenue, expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

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

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.

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("USGAAP"). The accompanying Consolidated Financial Statements include the accounts of the Company, its wholly owned subsidiaries and its variable interest entity ("VIE").

Variable Interest Entity (VIE)

DXP is the primary beneficiary of a VIE in which DXP owns 47.5% of the equity. DXP consolidates the financial statements of the VIE with the financial statements of DXP. As of December 31, 2017, the total assets of the VIE were approximately \$5.2 million including approximately \$4.5 million of fixed assets. DXP is the primary customer of the VIE. Consolidation of the VIE increased cost of sales by approximately \$0.6 million and \$1.3 million for the twelve months ended December 31, 2017 and 2016, respectively. The Company recognized a related income tax

benefit of \$0.2 million and \$0.3 million related to the VIE for the years ended December 31, 2017 and 2016, respectively. At December 31, 2017, the owners of the 52.5% of the equity not owned by DXP included employees of DXP.

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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 customers may 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, and Canada. 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 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.

Uncertainties require the Company to make frequent judgments and estimates regarding a customer's ability to pay amounts due in order to assess and quantify an appropriate allowance for doubtful accounts. The primary factors used to quantify the allowance are customer delinquency, bankruptcy, and the Company's estimate of its ability to collect outstanding receivables based on the number of days a receivable has been outstanding.

The majority of the Company's customers operate in the energy industry. The cyclical nature of the industry may affect customers' operating performance and cash flows, which could impact the Company's ability to collect on these obligations.

The Company continues to monitor the economic climate in which its customers operate and the aging of its accounts receivable. The allowance for doubtful accounts is based on the aging of accounts and an individual assessment of each invoice. At December 31, 2017, the allowance was 5.1% of the gross accounts receivable, compared to an allowance of 5.2% a year earlier. While credit losses have historically been within expectations and the provisions established, should actual write-offs differ from estimates, revisions to the allowance would be required.

Impairment of Goodwill and Other Indefinite Intangible Assets

The Company tests goodwill and other indefinite lived intangible assets for impairment on an annual basis in the fourth quarter and when events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company assigns the carrying value of these intangible assets to its "reporting units" and applies the test for goodwill at the reporting unit level. A reporting unit is defined as an operating segment or one level below a segment (a "component") if the component is a business and discrete information is prepared and reviewed regularly by segment management. As of December 31, 2017 DXP Core Service Centers ("Core SC"), DXP Core IPS, and DXP Core Supply Chain Services ("Core SCS") had goodwill.

The Company's goodwill impairment assessment first permits evaluating qualitative factors to determine if a reporting unit's carrying value would more likely than not exceed its fair value. If the Company concludes, based on the qualitative assessment, that a reporting unit's carrying value would more likely than not exceed its fair value, the Company would perform a two-step quantitative test for that reporting unit. When a quantitative assessment is performed, the first step is to identify a potential impairment, and the second step measures the amount of the impairment loss, if any. Goodwill is deemed to be impaired if the carrying amount of a reporting unit's goodwill exceeds its estimated fair value. For 2017 and 2016, the Company's annual tests of goodwill for impairment, including qualitative assessments of all of its reporting units of goodwill, determined that a quantitative impairment was not necessary.

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The Company determines fair value using widely accepted valuation techniques, including discounted cash flows and market multiples analyses, and through use of independent fixed asset valuation firms, as appropriate. These types of analyses contain uncertainties as they require management to make assumptions and to apply judgments regarding industry economic factors and the profitability of future business strategies. The Company's policy is to conduct impairment testing based on current business strategies, taking into consideration current industry and economic conditions, as well as the Company's future expectations. Key assumptions used in the discounted cash flow valuation model include, among others, discount rates, growth rates, cash flow projections and terminal value rates. Discount rates and cash flow projections are the most sensitive and susceptible to change as they require significant management judgment. Discount rates are determined using a weighted average cost of capital ("WACC"). The WACC considers market an industry data, as well as Company-specific risk factors for each reporting unit in determining the appropriate discount rate to be used. The discount rate utilized for each reporting unit is indicative of the return an investor would expect to receive for investing in a similar business. Management uses industry considerations and Company-specific historical and projected results to develop cash flow projections for each reporting unit. Additionally, as part of the market multiples approach, the Company utilizes market data from publicly traded entities whose businesses operate in industries comparable to the Company's reporting units, adjusted for certain factors that increase comparability.

The Company cannot predict the occurrence of events or circumstances that could adversely affect the fair value of goodwill. Such events may include, but are not limited to, deterioration of the economic environment, increase in the Company's weighted average cost of capital, material negative changes in relationships with significant customers, reductions in valuations of other public companies in the Company's industry, or strategic decisions made in response to economic and competitive conditions. If actual results are not consistent with the Company's current estimates and assumptions, impairment of goodwill could be required.

During the third quarter of 2015, the price of DXP's common stock and the price of crude oil declined over 40% and over 20%, respectively. The decline in oil prices reduced spending by our customers and reduced our revenue expectations. This sustained decline in crude oil prices, reduced capital spending by customers and reduced revenue expectations were determined to be a triggering event during the third quarter of 2015. This triggering event required us to perform testing for possible goodwill impairment in two of our reporting units, and our step one testing indicated there was an impairment in the B27 IPS and B27 SC reporting units. No triggering event was identified in our other reporting units during the third quarter. Accounting Standards Codification 350 Intangibles – Goodwill and Other ("ASC 350") step two of the goodwill impairment testing for the reporting units was performed preliminarily during the third quarter of 2015. Our preliminary analysis concluded that \$48.0 million of our B27 IPS reporting unit's goodwill and \$9.8 of our B27 SC reporting unit's goodwill was impaired. The remaining goodwill for the B27 IPS and B27 SC reporting units at September 30, 2015 was \$4.9 million and \$10.3 million, respectively. The third quarter of 2015 ASC 350 step two testing was completed in the fourth quarter of 2015 without any adjustment to the amount recorded in the third quarter of 2015.

As of October 1, 2015, DXP performed a qualitative assessment ("Step 0") to determine whether DXP was required to proceed to ASC 350 step one of the impairment analysis for any of its reporting units. It is the position of DXP that the factors taken into the Step 0 analysis failed to meet the more likely than not criteria that the fair value of any of our reporting units had fallen below its carrying value as of October 1, 2015.

During the fourth quarter of 2015, the price of DXP's common stock and the price of crude oil declined over 16% and over 18%, respectively. Actual earnings before interest, taxes, depreciation and amortization ("EBITDA") for the fourth quarter of 2015 for the Core SCS and Core SC reporting units exceeded the EBITDA amounts in the October 1, 2015 Step 0 analysis. Therefore, evidence of a fourth quarter triggering event for these two reporting units does not exist. Additionally, the fair value of each of these reporting units is substantially in excess of each reporting units carrying value as of October 1, 2015. Actual EBITDA for the fourth quarter of 2015 for the Core IPS reporting unit was below the EBITDA amount in the October 1, 2015 Step 0 analysis. Therefore, DXP updated the 2016 through 2020 forecasts

for the Core IPS reporting unit. The forecasted EBITDA for 2016 through 2020 in the updated forecast declined less than \$1 million from the October 1, 2015 forecast. The effect of this decline was more than offset by a \$12 million reduction in the carrying value of the Core IPS reporting unit at December 31, 2015 from the October 1, 2015 value. Therefore, evidence of a triggering event for this reporting unit does not exist. Additionally, the fair value of this reporting unit is substantially in excess of its carrying value as of October 1, 2015.

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Actual EBITDA for the fourth quarter of 2015 for the B27 IPS and B27 SC reporting units were below the EBITDA amounts in the October 1, 2015 Step 0 analysis. Therefore, DXP updated the 2016 through 2020 forecasts for the B27 IPS and B27 SC reporting units. The forecasted EBITDA for 2016 through 2020 in the updated forecasts declined significantly from the October 1, 2015 forecast. The declines in the forecasted EBITDA for these two reporting units were determined to be a triggering event during the fourth quarter of 2015. This triggering event required us to perform testing for possible goodwill impairment in these two reporting units, and our ASC 350 step one testing indicated there may be an impairment in our B27 IPS and B27 SC reporting units. ASC 350 step two testing for reporting units was performed during the fourth quarter of 2015. Our analysis concluded that \$4.9 million of our B27 IPS reporting unit's goodwill was impaired, and \$5.0 million of our B27 SC reporting unit's goodwill was impaired. The remaining goodwill for the B27 IPS and B27 SC reporting units at December 31, 2015 was zero and \$5.3 million, respectively.

Impairment of Long-Lived Assets, Excluding Goodwill

The Company tests long-lived assets or asset groups for recoverability on an annual basis and when events or changes in circumstances indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to: significant decreases in the market price of the asset; significant adverse changes in the business climate or legal factors; accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and current expectation that the asset will more likely than not be sold or disposed significantly before the end of its estimated useful life.

Recoverability is assessed based on the carrying amount of the asset and its fair value which is generally determined based on the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset, as well as specific appraisal in certain instances. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value. No impairment was recorded for property and equipment and intangible assets with indefinite or determinable lives during 2017, 2016 and 2015.

Revenue Recognition

For binding, long-term 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. Changes in estimated profitability may periodically result in revisions to revenue and expenses and are recognized in the period such revisions become probable. If at any time expected costs exceed the value of the contract, the loss is recognized immediately. Revenues of approximately \$40.6 million, \$31.5 million, and \$47.5 million were recognized on contracts in process for the years ended December 31, 2017, 2016, and 2015, respectively. 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.

The Company reserves for potential customer returns based upon the historical level of returns. Reserves for customer returns were \$0.3 and \$0.2 million at December 31, 2017 and 2016, respectively.

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 \$175,000 of risk on each medical claim for our employees and their dependents with the exception of less than 0.05% of employees where a higher risk is retained. 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, 2017 and 2016 was approximately \$2.7 million and \$3.1 million, respectively.

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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. The fair value estimates are developed using the best information available. Third party valuation specialists assist in valuing the Company's significant acquisitions. Our purchase price allocation methodology contains uncertainties because it requires management to make assumptions and to apply judgment to estimate the fair value of acquired assets and liabilities. Management estimates the fair value of assets and liabilities based upon quoted market prices, the carrying value of the acquired assets and widely accepted valuation techniques, including the income approach and the market approach. Unanticipated events or circumstances may occur which could affect the accuracy of our fair value estimates, including assumptions regarding industry economic factors and business strategies. We typically engage an independent valuation firm to assist in estimating the fair value of goodwill and other intangible assets. We do not expect that there will be material change in the future estimates or assumptions we use to complete the purchase price allocation and estimate the fair values of acquired assets and liabilities. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to losses or gains that could be material. DXP did not complete any acquisitions during 2017 or 2016.

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 under a more likely than not criterion.

Accounting for Uncertainty in Income Taxes

A position taken or expected to be taken in a tax return is 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 2012. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as operating expenses. 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.

RECENT ACCOUNTING PRONOUNCEMENTS

Standards Effective in 2017 or Earlier

Accounting Changes and Error Corrections. In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-03 ("ASU 2017-03"), Accounting Changes and Error Corrections (Topic 250) and Investments-Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings. This update adds language to the SEC Staff Guidance in relation to ASU 2014-09, ASU 2016-02, and ASU 2016-13. This ASU 2017-03 provides the SEC Staff view that a registrant should consider additional quantitative and qualitative disclosures related to the previously mentioned ASUs in connection with the status and impact of their adoption. This guidance, which was effective immediately, did not have a material impact on our Condensed Consolidated Financial

Statements.

Compensation – Stock Compensation. In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The update aims to simplify aspects of accounting for share-based payment award transactions, including (a) income tax consequences, (b) classification of awards as either equity or liabilities, and (c) classification on the statement of cash flows. This pronouncement is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company adopted the ASU January 1, 2017 and it had the following impact on the Company’s Condensed Consolidated Financial Statements:

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<u>Topic</u>	<u>Method of Adoption</u>	<u>Impact on Consolidated Financial Statements</u>
Recognize all excess tax benefits and tax deficiencies as income tax benefit or expense	Prospective	The Company recognized \$0.1 million of excess tax benefit in income taxes for the year ended December 31, 2017, decreasing the effective tax rate for the year.
Excess tax benefits and deficiencies on the statement of cash flows are classified as an operating activity	Prospective	The Company recognized \$0.1 million of excess tax benefit for the year ended December 31, 2017 as an operating activity. Prior to the adoption of the ASU 2016-09, the excess tax expense for the year ended December 31, 2016 of \$0.6 million was recognized as a financing activity. The excess tax expense for the year ended December 31, 2015 was zero.
Employee taxes paid when an employer withholds shares for tax-withholding purposes on the statement of cash flows are classified as a financing activity	Retrospective	The Company reclassified \$0.2 million and \$0.8 million of employee taxes paid from cash flows from operating activities to cash flows from financing activities on the Consolidated Statements of Cash Flows for the year ended December 31, 2016 and December 31, 2015.
Accounting for forfeitures and tax withholding elections	Prospective	The Company has not changed its accounting policy for forfeitures. There is no significant impact on Consolidated Financial Statements.

Income Taxes. In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes. The update requires entities to present deferred tax assets and liabilities as noncurrent in a classified balance sheet. The update simplifies the current guidance, which requires entities to separately present deferred tax assets and liabilities as current and noncurrent in a classified balance sheet. This pronouncement is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within. The Company adopted this ASU January 1, 2017 and reclassified \$9.5 million of current deferred income tax assets from current assets to non-current deferred income tax liabilities on the Condensed Consolidated Balance Sheet as of December 31, 2016.

Inventory. In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330), Simplifying the Measurement of Inventory. The amendments in ASU 2015-11 clarify the subsequent measurement of inventory requiring an entity to subsequently measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less reasonably predictable costs of completion, disposal, and transportation. This ASU applies only to inventory that is measured using the first-in, first-out (FIFO) or average cost method. Subsequent measurement is unchanged for inventory measured using last-in, first-out (LIFO) or the retail inventory method. The amendments in ASU 2015-11 should be applied prospectively and are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The Company adopted this ASU January 1, 2017 and it did not have a material impact on the Company's Condensed Consolidated Financial Statements.

Statement of Cash Flows. In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230), Classification of Restricted Cash. The amendments in ASU 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The amounts should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in ASU 2016-18 should be applied retrospectively and are effective for financial statements issued for

fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company early adopted this ASU September 30, 2017 and classified \$3.5 million of cash to restricted cash on the Condensed Consolidated Balance Sheet as of December 31, 2017. This cash deposit was required as collateral for letters of credit outstanding under our previously existing credit facility.

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Standards Effective in 2018 or Later

Compensation - Stock Compensation. In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. An entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments in this ASU are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted. The amendments in this ASU should be applied prospectively to an award modified on or after the adoption date. The Company is currently assessing the impact, if any, that this ASU will have upon adoption.

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

Business Combinations. In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. This ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. The effective date of this ASU is for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU is not expected to have a material impact on the Company's Consolidated Financial Statements.

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

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

Leases. In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The update requires organizations that lease assets (“lessees”) to recognize the assets and liabilities for the rights and obligations created by leases with terms of more than 12 months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee remains dependent on its classification as a finance or operating lease. The criteria for determining whether a lease is a finance or operating lease has not been significantly changed by this ASU. The ASU also requires additional disclosure of the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. This pronouncement is effective for financial statements issued for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that this standard will have on its Consolidated Financial Statements.

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Financial Instruments. In January 2016, the FASB issued ASU 2016-01, Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities. This change to the financial instrument model primarily affects the accounting for equity investments, financial liabilities under fair value options and the presentation and disclosure requirements for financial instruments. The effective date for the standard is for fiscal years and interim periods within those years beginning after December 15, 2017. Certain provisions of the new guidance can be adopted early. The Company is evaluating the impact of this ASU.

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

The Company has evaluated the provisions of the new standard and is in the process of assessing its impact on financial statements, information systems, business processes and financial statement disclosures. We have engaged third party consultants to assist us in assessing our contracts with customers, processes and controls required to address the impact that ASU No. 2014-09 will have on our business. The Company believes that our current plan will enable us to implement our new procedures and controls; and assess the cumulative effect of applying ASU No. 2014-09 at the date of initial application. Based on our overall assessment performed to date, the standard is not expected to have a material impact on the Company's Consolidated Financial Statements.

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, 2017, a 100 basis point increase in interest rates would increase our annual interest expense by approximately \$2.5 million. Also see "Risk Factors," included in Item 1A of this Report for additional risk factors associated with our business.

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

Principal Amount By Expected Maturity
(in thousands, except percentages)

	2018	2019	2020	2021	2022	There- after	Total	Fair Value
Fixed Rate Long- term Debt	\$881	\$905	\$936	\$-	\$ -	\$ -	\$2,722	\$2,722
Fixed Interest Rate	2.9 %	2.9 %	2.9 %	-	-	-	-	-
Floating Rate Long-term Debt	\$2,500	\$2,500	\$2,500	\$2,500				