

DXP ENTERPRISES INC  
Form 10-Q  
July 27, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

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 TX

77040

(Address of principal executive offices)

(Zip Code)

713/996-4700

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated Filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Number of shares outstanding of each of the issuer's classes of common stock, as of July 26, 2006:

Common Stock: 5,124,134

PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

DXP ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	June 30, 2006		December 31, 2005
	(Unaudited)		
<b>ASSETS</b>			
Current assets:			
Cash	\$ 2,441		\$ 570
Trade accounts receivable, net of allowances for doubtful accounts			

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of \$2,019 in 2006 and \$1,835 in 2005	38,517		29,279
Inventories, net	29,985		22,811
Prepaid expenses and other current assets	5,159		541
Federal income taxes recoverable	1,585		2,033
Deferred income taxes	925		968
Total current assets	78,612		56,202
Property and equipment, net	9,968		8,752
Goodwill and other intangibles	13,618		7,436
Other assets	716		530
Total assets	\$ 102,914		\$ 72,920
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Current portion of long-term debt	\$ 2,139		\$ 1,358
Trade accounts payable	22,512		15,919
Accrued wages and benefits	4,667		5,012
Customer advances	4,778		2,209
Federal income taxes payable	-		214
Other accrued liabilities	3,657		3,365
Total current liabilities	37,753		28,077
Long-term debt, less current portion	36,274		25,109
Deferred income taxes	-		115
Minority interest in consolidated subsidiary	10		30
<b>Shareholders' equity:</b>			
Series A preferred stock, 1/10 <sup>th</sup> vote per share; \$1.00 par value; liquidation preference of \$100 per share (\$112,000 at June 30, 2006);	1		1

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1,000,000 shares authorized; 1,122 shares issued and outstanding			
Series B convertible preferred stock, 1/10 <sup>th</sup> vote per share; \$1.00 par value; \$100 stated value; liquidation preference of \$100 per share (\$1,500,000 at June 30, 2006); 1,000,000 shares authorized; 15,000 shares issued and outstanding	15		15
Common stock, \$0.01 par value, 100,000,000 shares authorized; 5,124,134 and 4,795,402 shares issued and outstanding, respectively	51		48
Paid-in capital	5,772		1,894
Retained earnings	23,878		18,471
Notes receivable from David R. Little, CEO	(840)		(840)
Total shareholders' equity	28,877		19,589
Total liabilities and shareholders' equity	\$ 102,914		\$ 72,920

See notes to condensed consolidated financial statements.

DXP ENTERPRISES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2006		2005	2006		2005

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Sales	\$ 69,768		\$ 45,462		\$ 132,280		\$ 87,252
Cost of sales	50,648		33,218		95,807		64,039
Gross profit	19,120		12,244		36,473		23,213
Selling, general and administrative expense	13,851		9,741		26,770		19,195
Operating income	5,269		2,503		9,703		4,018
Other income	11		17		18		27
Interest expense	(480)		(273)		(843)		(517)
Minority interest in (income) loss of consolidated subsidiary	(1)		34		20		97
Income before taxes	4,799		2,281		8,898		3,625
Provision for income taxes	1,849		804		3,446		1,294
Net income	2,950		1,477		5,452		2,331
Preferred stock dividend	22		22		45		45
Net income attributable to common shareholders	\$ 2,928		\$ 1,455		\$ 5,407		\$ 2,286
Basic income per share	\$ 0.57		\$ 0.35		\$ 1.08		\$ 0.56
Weighted average common shares outstanding	5,115		4,167		5,001		4,115
Diluted income per share	\$ 0.51		\$ 0.26		\$ 0.95		\$ 0.41
Weighted average common and common equivalent shares outstanding	5,764		5,741		5,726		5,684
See notes to condensed consolidated financial statements.							

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

	SIX MONTHS ENDED		
	JUNE 30		
	2006		2005
OPERATING ACTIVITIES:			
Net income	\$ 5,452		\$ 2,331
Adjustments to reconcile net income to net cash provided			
by (used in) operating activities			
Depreciation	553		474
(Benefit) provision for deferred income taxes	(37)		(40)
Compensation expense on stock options and restricted stock	15		-
Minority interest in loss of consolidated subsidiary	(20)		(97)
Tax benefit related to exercise of stock options	(2,993)		-
Changes in operating assets and liabilities:			
Trade accounts receivable	(7,898)		(2,967)
Inventories	(6,232)		(1,950)
Prepaid expenses and other current assets	(4,825)		(489)
Accounts payable and accrued liabilities	8,367		3,497
Net cash (used in) provided by operating activities	(7,618)		759
INVESTING ACTIVITIES:			

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Purchase of property and equipment	(1,401)		(291)
Purchase of businesses	(4,238)		-
Proceeds from sale of property and equipment	-		932
Net cash (used in) provided by investing activities	(5,639)		641
FINANCING ACTIVITIES:			
Proceeds from debt	55,536		86,865
Principal payments on revolving line of credit, long-term debt, and notes payable to bank	(44,227)		(88,756)
Dividends paid in cash	(45)		(45)
Proceeds from issuance of common stock	434		-
Proceeds from exercise of stock options	583		288
Payments for employment taxes related to exercise of stock options	(146)		-
Tax benefit related to exercise of stock options	2,993		-
Net cash provided by (used in) financing activities	15,128		(1,648)
INCREASE (DECREASE) IN CASH	1,871		(248)
CASH AT BEGINNING OF PERIOD	570		2,303
CASH AT END OF PERIOD	\$ 2,441		\$ 2,055
See notes to condensed consolidated financial statements.			

DXP ENTERPRISES INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

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

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission.

NOTE 2: THE COMPANY

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

NOTE 3: STOCK-BASED COMPENSATION

Adoption of SFAS 123(R)

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standard 123(R) "*Share-Based Payment*" ("SFAS 123(R)") using the modified prospective transition method. In addition, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 "*Share-Based Payment*" ("SAB 107") in March, 2005, which provides supplemental SFAS 123(R) application guidance based on the views of the SEC. Under the modified prospective transition method, compensation cost recognized in the quarterly period ended June 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted beginning January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). In accordance with the modified prospective transition method, results for prior periods have not been restated.

The adoption of SFAS 123(R) resulted in stock compensation expense for the three months and six months ended June 30, 2006 of \$2,200 and \$4,400, respectively, all of which was recorded to operating expenses.

The Black-Scholes option-pricing model was used to estimate the option fair values. The option-pricing model requires a number of assumptions, of which the most significant are, expected stock price volatility, the expected pre-vesting forfeiture rate and the expected option term (the amount of time from the grant date until the options are exercised or expire). Expected volatility was calculated based upon actual historical stock price movements over periods equal to the expected option term. The expected option term was calculated using the "simplified" method permitted by SAB 107.

Prior to the adoption of SFAS 123(R), the Company presented any tax benefits from deductions resulting from the exercise of stock options within operating cash flows in the condensed consolidated statements of cash flow. SFAS



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123(R) requires tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options ("excess tax benefits") to be classified and reported as both an operating cash outflow and a financing cash inflow upon adoption of SFAS 123(R).

Pro-Forma Stock Compensation Expense for the Three Months and Six Months Ended June 30, 2005

For the three months and six months ended June 30, 2005, the Company applied the intrinsic value method of accounting for stock options as prescribed by APB 25. No compensation expense was recognized during the six months ended June 30, 2005. If compensation expense had been recognized based on the estimated fair value of each option granted in accordance with the provisions of SFAS 123 as amended by Statement of Financial Accounting Standard 148, our net income would have been reduced to the following pro-forma amounts (in thousands, except per share amounts):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Reported net income attributable to common shareholders	\$ 1,455	\$ 2,286
Deduct: Stock-based employee compensation expense, determined under SFAS 123, net of tax	\$ (109)	\$ (111)
Net income, pro forma	\$ 1,346	\$ 2,175
Income per share - basic, as reported	\$ 0.35	\$ 0.56
Income per share - diluted, as reported	\$ 0.26	\$ 0.41
Income per share - basic, pro forma	\$ 0.32	\$ 0.53
Income per share - diluted, pro forma	\$ 0.24	\$ 0.39

Stock Options as of the Six Month Period Ended June 30, 2006

No future grants will be made under the Company's stock option plans. No grants of stock options have been made by the Company since July 1, 2005. No grants of stock options were made in the six months ended June 30, 2006. As of June 30, 2006, all outstanding options were non-qualified stock options.

The following table summarizes stock options outstanding and changes during the six months ended June 30, 2006:

	Outstanding Options						
	Number of Shares		Weighted Average Exercise Price		Weighted Average Remaining Contractual Term (in years)		Aggregate Intrinsic Value
Options outstanding at January 1, 2006	621,430		\$ 1.44				
Exercised	(232,719)		\$ 1.26				
Canceled or forfeited	(5,130)		\$ 12.00				
Options outstanding at March 31, 2006	383,581		\$ 1.40		5.4		\$ 12,794,386
Exercised	(72,400)		\$ 1.36				
Options outstanding at June 30, 2006	311,181		\$ 1.41		5.4		9,288,274
Options exercisable at June 30, 2006	302,081		\$ 1.42				\$ 8,956,457

The total intrinsic value, or the difference between the exercise price and the market price on the date of exercise, of all options exercised during the six months ended June 30, 2006, was approximately \$8.7 million. Cash received from stock options exercised during the six months ended June 30, 2006 was \$583,000.

Stock options outstanding and currently exercisable at June 30, 2006 are as follows:

	Options Outstanding	Options Exercisable

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Range of exercise prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Options Exercisable	Average Exercise Price
\$0.92 - \$2.50	291,181	5.2	\$1.12	282,081	\$1.12
\$4.53 - \$6.72	20,000	8.4	\$5.63	20,000	\$5.63
	311,181	5.4	\$1.41	302,081	\$1.42

Total estimated unrecognized compensation cost from unvested stock options as of June 30, 2006 was approximately \$4,000, which is expected to be recognized over approximately six months.

Restricted Stock.

Under a restricted stock plan approved by our shareholders in July 2005 (the "Restricted Stock Plan"), directors, consultants and employees may be awarded shares of DXP's common stock. The shares of stock granted as of June 30, 2006 vest 20% a year for five years after the grant date. Prior to July 24, 2006, the Restricted Stock Plan provided that on each July 1 during the term of the plan each non-employee director of DXP would be granted 3,000 shares of restricted stock which will vest one year after the grant date. On July 24, 2006 the Restricted Stock Plan was amended to grant to each non-employee director of DXP the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on such July 1. The fair value of restricted stock awards is measured based upon the closing prices of DXP's common stock on the grant dates and is recognized as compensation expense over the vesting period of the awards.

The following table provides certain information regarding the shares authorized and outstanding under the Restricted Stock Plan at June 30, 2006:

Number of shares authorized for grants	300,000
Number of shares outstanding	15,000
Number of shares available for future grants	285,000
Weighted-average grant price of outstanding shares	\$ 18.85

Changes in restricted stock for the six months ended June 30, 2006 were as follows:

	Number	Weighted Average

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	Of Shares	Grant Price
Outstanding at December 31, 2005	-	-
Granted	15,000	\$ 18.85
Outstanding at June 30, 2006	15,000	\$ 18.85

At June 30, 2006, there were no shares vested under the Restricted Stock Plan. Compensation expense recognized in the six months ended June 30, 2006 was \$19,000. Unrecognized compensation expense under the Restricted Stock Plan was \$263,900 and \$0 at June 30, 2006 and December 31, 2005, respectively.

NOTE 4: INVENTORY

The Company uses the last-in, first-out ("LIFO") method of inventory valuation for approximately 85 percent of its inventories. Remaining inventories are accounted for using the first-in, first-out ("FIFO") method. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must necessarily be based on management's estimates of expected year-end inventory levels and costs. Because these are subject to many forces beyond management's control, interim results are subject to the final year-end LIFO inventory valuation. The reconciliation of FIFO inventory to LIFO basis is as follows:

	June 30, 2006		December 31, 2005
	(in Thousands)		
Finished goods	\$ 31,316		\$ 25,740
Work in process	3,256		1,237
Inventories at FIFO	34,572		26,977
Less - LIFO allowance	(4,587)		(4,166)
Inventories	\$ 29,985		\$ 22,811

NOTE 5: EARNINGS PER SHARE DATA

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

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	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2006		2005	2006		2005
Basic:						
Weighted average shares outstanding	5,114,732		4,167,102	5,001,378		4,114,884
Net income	\$ 2,950,000		\$ 1,477,000	\$ 5,452,000		\$ 2,331,000
Convertible preferred stock dividend	(22,000)		(22,000)	(45,000)		(45,000)
Net income attributable to common shareholders	\$ 2,928,000		\$ 1,455,000	\$ 5,407,000		\$ 2,286,000
Per share amount	\$ 0.57		\$ 0.35	\$ 1.08		\$ 0.56
Diluted:						
Weighted average shares outstanding	5,114,732		4,167,102	5,001,378		4,114,884
Net effect of dilutive stock options and restricted stock - based on the treasury stock method	229,131		1,154,241	304,728		1,149,567
Assumed conversion of convertible preferred stock	420,000		420,000	420,000		420,000
Total	5,763,863		5,741,343	5,726,106		5,684,451
Net income attributable to common	\$ 2,928,000		\$ 1,455,000	\$ 5,407,000		\$ 2,286,000

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shareholders						
Convertible preferred stock dividend	22,000		22,000		45,000	45,000
Net income for diluted earnings per share	\$ 2,950,000		\$ 1,477,000		\$ 5,452,000	\$ 2,331,000
Per share amount	\$ 0.51		\$ 0.26		\$ 0.95	\$ 0.41

NOTE 6: SEGMENT REPORTING

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

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

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	MRO	Electrical Contractor	Total	MRO	Electrical Contractor	Total
2006						
Sales	\$ 69,089	\$ 679	\$ 69,768	\$130,965	\$ 1,315	\$132,280
Operating income	5,150	119	5,269	9,531	172	9,703
I n c o m e before tax	4,719	80	4,799	8,804	94	8,898
2005						
Sales		\$ 569		\$86,121	\$ 1,131	\$ 87,252

	\$		\$				
	44,893		45,462				
Operating income	2,453	50	2,503	3,922	96	4,018	
I n c o m e before tax	2,269	12	2,281	3,602	23	3,625	

## NOTE 7: ACQUISITIONS

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

On May 31, 2006 DXP purchased the businesses of Production Pump and Machine Tech. DXP paid approximately \$8.1 million for the acquired businesses and assumed approximately \$1.2 million worth of liabilities. The purchase price consists of approximately \$4.6 million paid in cash and \$3.5 million in the form of promissory notes payable to the former owners of the acquired businesses. In addition, DXP may pay \$2.0 million of future payments which are contingent upon earnings over the next five years. The cash portion was funded by utilizing available capacity under DXP's bank revolving credit facility. The promissory notes, which are subordinated to DXP's bank revolving credit facility, bear interest at prime minus 2%.

The allocation of purchase price reflected in the June 30, 2006 condensed consolidated balance sheet is preliminary. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in the estimates of the fair value of assets acquired and liabilities assumed. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on May 31, 2006 (in thousands):

Cash	\$ 408
Accounts Receivable	1,340
Inventory	942
Property and equipment	368
Goodwill and intangibles	6,159
Other assets	103
Assets acquired	9,320
Current liabilities assumed	528
Non-current liabilities	636

assumed	
Net assets acquired	\$ 8,156

The pro forma unaudited results of operations for the Company on a consolidated basis for the six months ended June 30, 2006 and 2005 assuming the consummation as of January 1, 2005 of acquisitions completed in 2005 and 2006, are as follows:

	Six Months Ended	
	June 30	
	2006	2005
Net sales	\$137,588	\$105,715
Net income	\$ 5,840	\$ 3,089
Per share data		
Basic earnings	\$ 1.16	\$ 0.73
Diluted earnings	\$ 1.02	\$ 0.54

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

RESULTS OF OPERATIONS

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006	%	2005	%	2006	%	2005	%
	(in thousands, except percentages and per share amounts)							
Sales	\$69,768	100.0	\$45,462	100.0	\$132,280	100.0	\$87,252	100.0



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Cost of sales	50,648		72.6		33,218		73.1		95,807		72.4		64,039		73.4
Gross profit	19,120		27.4		12,244		26.9		36,473		27.6		23,213		26.6
Selling, general & administrative	13,851		19.9		9,741		21.4		26,770		20.2		19,195		22.0
Operating income	5,269		7.5		2,503		5.5		9,703		7.4		4,018		4.6
Interest expense	(480)		(.7)		(273)		(0.6)		(843)		(0.7)		(517)		(0.6)
Minority interest in loss of consolidated subsidiary	(1)		-		34		0.1		20		-		97		0.1
Other income	11		-		17		--		18		-		27		--
Income before income taxes	4,799		6.8		2,281		5.0		8,898		6.7		3,625		4.1
Provision for income taxes	1,849		2.6		804		1.8		3,446		2.6		1,294		1.5
Net income	\$2,950		4.2		\$ 1,477		3.2		5,452		4.1		\$2,331		2.6
Per share amounts															
Basic earnings per share	\$ 0.57				\$ 0.35				\$ 1.08				\$ 0.56		
Diluted earnings per share	\$ 0.51				\$ 0.26				\$ 0.95				\$ 0.41		

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Three Months Ended June 30, 2006 compared to Three Months Ended June 30, 2005

**SALES.** Revenues for the quarter ended June 30, 2006, increased \$24.3 million, or 53.5%, to approximately \$69.8 million from \$45.5 million for the same period in 2005. Sales for the MRO segment increased \$24.2 million, or 53.9%, primarily due to a broad based increase in sales of pumps, bearings, safety products and mill supplies to companies engaged in oilfield service, oil and gas production, mining, electricity generation and petrochemical processing. The sales increases appear to be at least partially the result of an improving economy and high energy prices. Sales by the two businesses acquired in 2005 and the businesses acquired on May 31, 2006 accounted for \$9.1 million of the 2006 sales increase. Excluding sales of the acquired businesses, sales for the MRO segment increased 33.6%. Sales for the Electrical Contractor segment increased by \$0.1 million, or 19.3%, for the current quarter when compared to the same period in 2005. The sales increase for the Electrical Contractor segment resulted from the sale of more specialty electrical products.

**GROSS PROFIT.** Gross profit as a percentage of sales increased by approximately 0.5% for the second quarter of 2006, when compared to the same period in 2005. Gross profit as a percentage of sales for the MRO segment increased to 27.3% for the three months ended June 30, 2006, from 26.8% in the comparable period of 2005. This increase can be primarily attributed to increased margins on pump related equipment sold by the MRO segment. Gross profit as a percentage of sales for the businesses acquired in 2005 and 2006 is higher than the same percentage for the remainder of our business and accounts for the majority of the increase in the gross profit as a percentage of sales for the MRO segment. Gross profit as a percentage of sales for the Electrical Contractor segment increased to 42.6% for the three months ended June 30, 2006, from 39.7% in the comparable period of 2005. This increase resulted from increased sales of higher margin specialty electrical products.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the quarter ended June 30, 2006 increased by approximately \$4.1 million when compared to the same period in 2005. The increase is primarily attributed to increased salaries, incentive compensation, employee benefits and payroll related expenses for the three months ended June 30, 2006 compared to the same period in 2005. Salaries have increased partially as a result of increased headcount due to acquisitions and hiring more sales related personnel for the purpose of increasing sales. Incentive compensation has increased as a result of increased gross profit and income before tax. The majority of our employees receive incentive compensation which is based upon gross profit or income before tax. Selling, general and administrative expense associated with the businesses acquired in 2005 and 2006 accounted for approximately \$2.1 million of the \$4.1 million increase. As a percentage of revenue, the 2006 expense decreased by approximately 1.5% to 19.9% from 21.4% for 2005 as a result of sales increasing more than the expense increased.

**OPERATING INCOME.** Operating income for the second quarter of 2006 increased 110.5% when compared to the same period in 2005. Operating income for the MRO segment increased 110.0% as a result of increased gross profit, partially offset by increased selling, general and administrative expense. Operating income for the Electrical Contractor segment increased 138.0% as a result of increased gross profit and reduced selling, general and administrative expense.

**INTEREST EXPENSE.** Interest expense for the quarter ended March 31, 2006 increased by 75.8% from the same period in 2005. This increase results from the combination of an approximate 200 basis point increase in market interest rates on floating rate debt and increased debt used to fund acquisitions and internal growth. The effect of the increase in market interest rates was partially offset by the lower margins on our new credit facility.

Six Months Ended June 30, 2006 compared to Six Months Ended June 30, 2005

**SALES.** Revenues for the six months ended June 30, 2006, increased \$45.0 million, or 51.6%, to approximately \$132.3 million from \$87.3 million for the same period in 2005. Sales for the MRO Segment increased \$44.8 million, or 52.1%, primarily due to a broad based increase in sales of pumps, bearings, safety products and mill supplies to companies engaged in oilfield service, oil and gas production, mining, electricity generation and petrochemical

processing. The sales increases appear to be at least partially the result of an improving economy and high energy prices. Sales by the two businesses acquired in 2005 and the businesses acquired on May 31, 2006 accounted for \$17.6 million of the 2006 sales increase. Excluding sales of the acquired businesses, sales for the MRO segment increased 31.6%. Sales for the Electrical Contractor segment increased by \$0.2 million, or 16.3%, for the six months when compared to the same period in 2005. The sales increase resulted from the sale of more commodity type electrical products.

**GROSS PROFIT.** Gross profit as a percentage of sales increased by approximately 1.0% for the first six months of 2006, when compared to the same period in 2005. Gross profit as a percentage of sales for the MRO segment increased to 27.5% for the six months ended June 30, 2006, from 26.4% in the comparable period of 2005. This increase can be primarily attributed to increased margins on pump related equipment sold by the MRO segment. Gross profit as a percentage of sales for the businesses acquired in 2005 and 2006 is higher than the same for the remainder of our business and accounts for the majority of the increase in the gross profit percentage for the MRO segment. Gross profit as a percentage of sales for the Electrical Contractor segment decreased to 38.9% for the six months ended June 30, 2006, from 39.3% in the comparable period of 2005. This decrease resulted from increased sales of lower margin commodity type electrical products.

**SELLING, GENERAL AND ADMINISTRATIVE.** Selling, general and administrative expense for the quarter ended June 30, 2006, increased by approximately \$7.6 million when compared to the same period in 2005. The increase is primarily attributed to increased salaries, incentive compensation, employee benefits and payroll related expenses for the six months ended June 30, 2006 compared to the same period in 2005. Salaries have increased partially as a result of increased headcount due to acquisitions and hiring more sales related personnel for the purpose of increasing sales. Incentive compensation has increased as a result of increased gross profit and income before tax. The majority of our employees receive incentive compensation which is based upon gross profit or income before tax. Selling, general and administrative expense associated with the businesses acquired in 2005 and 2006 accounted for approximately \$4.0 million of the \$7.6 million increase. As a percentage of revenue, the 2006 expense decreased by approximately 1.8% to 20.2% from 22.0% for 2005 as a result of sales increasing more than the expense increased.

**OPERATING INCOME.** Operating income for the first six months of 2006 increased 141.5% when compared to the same period in 2005. Operating income for the MRO segment increased 143.0% as a result of increased gross profit, partially offset by increased selling, general and administrative expense. Operating income for the Electrical Contractor segment increased 79.2% as a result of increased gross profit and reduced selling, general and administrative expense.

**INTEREST EXPENSE.** Interest expense for the six months ended June 30, 2006 increased by 63.1% from the same period in 2005. This increase results from the combination of an approximate 200 basis point increase in market interest rates on floating rate debt and increased debt used to fund acquisitions and internal growth. The effect of the increase in market interest rates was partially offset by the lower margins on our new credit facility.

## LIQUIDITY AND CAPITAL RESOURCES

### General Overview

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

We used \$7.6 million of cash in operating activities during the first six months of 2006 as compared to generating \$0.8 million during the first six months of 2005. This change between the two periods was primarily attributable to

larger increases in accounts receivable and inventory in the 2006 period compared to the 2005 period.

During the first six months of 2006, the amount available to be borrowed under our loan agreement with our bank lender (the "Credit Facility") increased from \$11.0 million at December 31, 2005 to \$12.6 million at June 30, 2006. This increase in availability resulted from the \$10 million increase in the credit facility partially offset by the \$9.1 million increase in the amount borrowed under the facility. The funds obtained from the increase in borrowings were used to fund acquisitions and operations, including increases in inventory and accounts receivable.

#### Credit Facility

On August 2, 2005, we entered into a new credit facility ("New Credit Facility") which replaced the previous credit facility ("Old Credit Facility"). On June 5, 2006 the New Credit Facility was amended to increase the maximum amount to \$40.0 million from \$30 million.

The New Credit Facility provides for borrowings up to an aggregate of the lesser of (i) a percentage of the collateral value based on a formula set forth therein or (ii) \$40.0 million, and matures July 31, 2009. The New Credit Facility is secured by receivables, inventory and intangibles. The New Credit Facility contains customary affirmative and negative covenants as well as financial covenants that are measured quarterly and require that we maintain a certain cash flow and other financial ratios.

The New Credit Facility allows us to borrow at LIBOR plus a margin ranging from 0.75% to 1.25% or prime minus a margin of 1.75% to 1.25%. At June 30, 2006, the LIBOR based rate was LIBOR plus 75 basis points. At June 30, 2006, the prime based rate was prime minus 175 basis points. The LIBOR and prime based rates under the New Credit Facility are generally 150 basis points and 175 basis points lower, respectively, than those assessed under the Old Credit Facility. At June 30, 2006, \$21 million was borrowed at an interest rate of 6.0% under the LIBOR option and \$6.3 million was borrowed at an interest rate of 6.25% under the prime option. Commitment fees of .125 percent per annum are payable on the portion of the New Credit Facility capacity not in use for borrowings at any given time. This fee is 12.5 basis points lower than the same fee under the Old Credit Facility. At June 30, 2006, we were in compliance with all covenants. In addition to the \$2.4 million of cash at June 30, 2006, we had \$12.6 million available for borrowings under the New Credit Facility at June 30, 2006.

The New Credit Facility's principal financial covenants include:

**Fixed Charge Coverage Ratio** - The New Credit Facility requires that the Fixed Charge Coverage Ratio be not less than 2.0 to 1.0 as of each fiscal quarter end, determined on a rolling four quarters basis, with "Fixed Charge Coverage Ratio" defined as the aggregate of net profit after taxes plus depreciation expense, amortization expense, and cash capital contributions minus dividends and distributions divided by the aggregate of the current maturity of long-term debt and capitalized lease payments.

**Debt to Credit Facility Adjusted EBITDA** - The New Credit Facility requires that the Company's ratio of Total Funded Debt to Credit Facility Adjusted EBITDA, determined on a rolling four quarters basis, not exceed 4.0 to 1.0 as of each quarter end. Total Funded Debt is defined under the Facility for financial covenant purposes as the sum of all obligations for borrowed money (excluding subordinated debt) plus all capital lease obligations. Credit Facility Adjusted EBITDA is defined under the credit facility for financial covenant purposes as net profit before tax, plus interest expense (net of capitalized interest expense), depreciation expense and amortization expense, inclusive of acquisitions.

#### Borrowings

	June 30,				Increase
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			December 31,	
	2006		2005	(Decrease)
	(in Thousands)			
Current portion of long-term debt	\$ 2,139		\$ 1,358	\$ 781
Long-term debt, less current portion	36,274		25,109	11,165
Total long-term debt	\$ 38,413		\$ 26,467	\$ 11,946 <sup>(2)</sup>
Amount available <sup>(1)</sup>	\$ 12,604		\$ 10,972	\$ 1,632 <sup>(3)</sup>

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

(2) The funds obtained from the increase in long-term debt were primarily used for acquisitions and in operations, primarily to fund the increase in inventory and accounts receivable.

(3) The \$1.6 million increase in the amount available is a result of the \$10 million increase in the New Credit Facility, partially offset by increased borrowings under the facility.

Performance Metrics

	June 30,			Increase
	2006		2005	(Decrease)
	(in Days)			
Days of sales outstanding	55.5		49.8	5.7
Inventory turns	6.4		6.9	(0.5)

Accounts receivable days of sales outstanding were 55.5 at June 30, 2006 compared to 49.8 at June 30, 2005. The increase resulted primarily from a change in customer mix which resulted in slower collection of accounts receivable. Annualized inventory turns were 6.4 at June 30, 2006 and 6.9 at June 30, 2005.

## Funding Commitments

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

## DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant estimates made by us in the accompanying financial statements relate to reserves for accounts receivable collectibility, inventory valuations, goodwill valuations, purchase accounting, income taxes and self-insured medical claims. Actual results could differ from those estimates.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's subjective or complex judgments. Below is a discussion of what we believe are our critical accounting policies.

### Revenue Recognition

We recognize revenues when an agreement is in place, price is fixed, title for product passes to the customer or services have been provided, and collectibility is reasonably assured.

### Allowance for Doubtful Accounts

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

### Inventory

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

### Goodwill

Goodwill attributable to our reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. Significant estimates used in the determination of fair value include estimates of future cash flows, future growth rates; costs of capital and estimates of market multiples. As required under current accounting standards, we test for impairment annually at year end unless factors otherwise indicate that impairment may have occurred. We did not have any impairments under the provisions of SFAS No. 142 as of December 31, 2005.

### Purchase Accounting

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

#### Income Taxes

In accordance with SFAS 109, Accounting for Income Taxes, we have recorded a net deferred tax asset of \$.9 million as of June 30, 2006. We believe it is more likely than not that this net deferred tax asset will be realized based primarily on the assumption of future taxable income.

#### Self-insured Medical Claims

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

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

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

Our market risk results from volatility in interest rates. Our exposure to interest rate risk relates primarily to our debt portfolio. Using floating interest rate debt outstanding at June 30, 2006, a 100 basis point change in interest rates would result in approximately a \$290,000 change in annual interest expense.

#### ITEM 4: CONTROLS AND PROCEDURES

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

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter (the quarter ended June 30, 2006) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### PART II: OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS.

No material developments have occurred in the asbestos related litigation or the litigation with BP America Production Company disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

#### ITEM 1A. RISK FACTORS

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No material changes have occurred in the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

DXP did not repurchase any DXP equity securities during the quarter ended June 30, 2006.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

### ITEM 5. OTHER INFORMATION.

None.

### ITEM 6. EXHIBITS

- 2.1 Asset Purchase Agreement between PMI Operating Company, Ltd., as Purchaser, Production Pump Systems of Levelland, L.P. and the Partners dated May 1, 2006 (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the Commission on June 2, 2006).
- 3.1 Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998)
- 3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4 (Reg. No. 333-10021), filed with the Commission on August 12, 1996).
- 10.1 First Amendment to Credit Agreement by and among DXP Enterprises, Inc., as Borrower, and Wells Fargo Bank, as Bank, dated as of August 2, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 6, 2006).
- 10.2 First Modification to Promissory Note by and among DXP Enterprises, Inc., as Borrower, and Wells Fargo Bank, as Bank, dated as of August 2, 2005 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 6, 2006).
- 10.3 Amendment No. One to Employment Agreement dated effective as of January 1, 2004, between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the



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Commission on July 25, 2006).

- 10.4 Amendment No. One to DXP Enterprises, Inc. 2005 Restricted Stock Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on July 25, 2006).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended. (Filed herewith).
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith).

SIGNATURES

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

DXP ENTERPRISES, INC.

(Registrant)

By: /s/MAC McCONNELL

Mac McConnell

Senior Vice-President/Finance and

Chief Financial Officer

Dated: July 27, 2006

Exhibit 31.1

CERTIFICATION

I, David R. Little, the Chief Executive Officer of DXP Enterprises, Inc., certify that:

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1. I have reviewed this quarterly report on Form 10-Q of DXP Enterprises, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's first fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
1. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

July 27, 2006

/s/ David R. Little

David R. Little

President and Chief Executive Officer

(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Mac McConnell, the Chief Financial Officer of DXP Enterprises, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of DXP Enterprises, Inc.;
  2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
1. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
    - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's first fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  1. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
    - a. all significant deficiencies and weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to

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record, process, summarize and report financial information; and

- b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

July 27, 2006

/s/ Mac McConnell

Mac McConnell

Senior Vice President and Chief Financial Officer

(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of DXP Enterprises, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company.

/s/David R. Little

David R. Little

President and Chief Executive Officer

July 27, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

CERTIFICATION

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of DXP Enterprises, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the "Report") fully complies with the requirements of Section

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13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company.

/s/Mac McConnell

Mac McConnell

Chief Financial Officer

July 27, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.