

DXP ENTERPRISES INC
Form 10-Q
May 08, 2009

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 March 31, 2009

or

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

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

Texas
(State or other jurisdiction of incorporation or organization)

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

7272 Pinemont, Houston, Texas 77040
(Address of principal executive offices)

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

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

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

Yes No

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

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

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

Number of shares of registrant's Common Stock outstanding as of May 7, 2009: 12,869,304.

PART I: FINANCIAL INFORMATION
ITEM 1: FINANCIAL STATEMENTS

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

	March 31, 2009 (unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash	\$ 6,283	\$ 5,698
Trade accounts receivable, net of allowances for doubtful accounts of \$3,579 in 2009 and \$3,494 in 2008	82,068	101,191
Inventories, net	111,724	119,097
Prepaid expenses and other current assets	3,195	2,851
Deferred income taxes	4,241	3,863
Total current assets	207,511	232,700
Property and equipment, net	20,155	20,331
Goodwill	99,716	98,718
Other intangibles, net of accumulated amortization of \$11,411 in 2009 and \$9,605 in 2008	43,421	45,227
Other assets	811	880
Total assets	\$ 371,614	\$ 397,856
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 14,047	\$ 13,965
Trade accounts payable	53,273	57,539
Accrued wages and benefits	12,820	12,869
Customer advances	1,339	2,719
Federal income taxes payable	4,331	7,894
Other accrued liabilities	7,511	8,660
Total current liabilities	93,321	103,646
Other liabilities	12	12
Long-term debt, less current portion	134,253	154,591
Deferred income taxes	10,314	9,419
Commitments and contingencies		
Shareholders' equity:		
Series A preferred stock, 1/10th vote per share; \$1.00 par value; liquidation preference of \$100 per share (\$112 at March 31, 2009); 1,000,000 shares authorized; 1,122 shares issued and outstanding	1	1

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Series B convertible preferred stock, 1/10th vote per share; \$1.00 par value; \$100 stated value; liquidation preference of \$100 per share (\$1,500 at March 31, 2009); 1,000,000 shares authorized; 15,000 shares issued and outstanding	15	15
Common stock, \$0.01 par value, 100,000,000 shares authorized; 12,869,304 in 2009 and 12,863,304 in 2008 shares outstanding	128	128
Paid-in capital	56,469	56,206
Retained earnings	77,101	73,838
Total shareholders' equity	133,714	130,188
Total liabilities and shareholders' equity	\$ 371,614	\$ 397,856

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

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

	Three Months Ended March 31,	
	2009	2008 (Restated)
Sales	\$ 157,604	\$ 168,499
Cost of sales	111,530	122,553
Gross profit	46,074	45,946
Selling, general and administrative expense	39,382	35,378
Operating income	6,692	10,568
Other income	14	13
Interest expense	(1,453)	(1,383)
Income before income taxes	5,253	9,198
Provision for income taxes	2,081	3,759
Net income	3,172	5,439
Preferred stock dividend	(15)	(23)
Net income attributable to common shareholders	\$ 3,157	\$ 5,416
Basic income per share	\$ 0.24	\$ 0.42
Weighted average common shares outstanding	13,079	12,857
Diluted income per share	\$ 0.23	\$ 0.39
Weighted average common and common equivalent shares outstanding	13,952	13,837

See notes to condensed consolidated financial statements.

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

	THREE MONTHS ENDED MARCH 31	
	2009	2008
OPERATING ACTIVITIES:		
Net income	\$ 3,172	\$ 5,439
Adjustments to reconcile net income to net cash provided by operating activities – net of acquisitions		
Depreciation	1,098	981
Amortization of intangibles	1,806	1,228
Compensation expense from restricted stock	262	227
Deferred income taxes	(356)	259
Changes in operating assets and liabilities, net of assets and liabilities acquired in business combinations:		
Trade accounts receivable	19,123	(4,076)
Inventories	7,373	1,274
Prepaid expenses and other current assets	(1,222)	(1,695)
Accounts payable and accrued liabilities	(9,424)	(1,644)
Net cash provided by operating activities	21,832	1,993
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(921)	(1,502)
Purchase of businesses, net of cash acquired	(52)	(3,822)
Net cash used in investing activities	(973)	(5,324)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	24,809	10,444
Principal payments on revolving line of credit and other long-term debt	(45,068)	(7,256)
Dividends paid in cash	(15)	(23)
Net cash (used in) provided by financing activities	(20,274)	3,165
INCREASE (DECREASE) IN CASH	585	(166)
CASH AT BEGINNING OF PERIOD	5,698	3,978
CASH AT END OF PERIOD	\$ 6,283	\$ 3,812

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, 2008, filed with the Securities and Exchange Commission.

NOTE 2: THE COMPANY

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

NOTE 3: NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS No. 157 are effective for the fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-2, which delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those years for all nonfinancial assets and nonfinancial liabilities, except those that are recognized at fair value in the financial statements on a recurring basis (at least annually). See Note 10 "Fair Value of Financial Assets and Liabilities" for additional information on the adoption of SFAS 157.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) requires the acquiring entity in a business combination to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. In addition, immediate expense recognition is required for transaction costs. SFAS 141(R) is effective for financial statements issued for fiscal years beginning after December 15, 2008, and adoption is prospective only. As such, if the Company enters into any business combinations after adoption of SFAS 141(R), a transaction may significantly affect the Company's financial position and earnings, but, not cash flows, compared to the Company's past acquisitions.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 (“SFAS 161”) SFAS 161 amends and expands the disclosure requirements of Statement 133 to provide a better understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and their effect on an entity’s financial position, financial performance, and cash flows. SFAS No. 161 also requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, or the Company’s quarter ended March 31, 2009. As this pronouncement is only disclosure-related, it does not and will not have an impact on the financial position and results of operations.

In April 2008, the FASB issued Staff Position No. FAS 142-3, Determination of the Useful Life of Intangible Assets (“FSP FAS 142-3”). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (“SFAS No. 142”). It is effective for financial statements issued for fiscal years beginning December 15, 2008, and interim periods within those fiscal years and should be applied prospectively to intangible assets acquired after the effective date.

Early adoption is not permitted. FSP FAS 142-3 also requires expanded disclosure related to the determination of useful lives for intangible assets and should be applied to all intangible assets recognized as of, and subsequent to, the effective date. The impact of FSP FAS 142-3 will depend on the size and nature of acquisitions completed by the Company on or after January 1, 2009.

In June 2008, the FASB issued Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share using the two-class method. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008 on a retrospective basis and was adopted by the Company in the first quarter of 2009. The Company has granted awards of restricted stock that contain non-forfeitable rights to dividends which are considered participating securities under FSP EITF 03-6-1. Because these awards are participating securities under FSP EITF 03-6-1, the Company is required to include these instruments in the calculation of earnings per share using the two-class method. The adoption of FSP EITF 03-6-1 reduced basic and diluted earnings per share for the three months ended March 31, 2008 and 2009 by \$0.1 and \$0.1, respectively. Basic earnings per share, diluted earnings per share, weighted average common shares outstanding and weighted average common and common equivalent shares outstanding for 2008 have been restated.

NOTE 4: STOCK-BASED COMPENSATION

Stock Options as of the Quarterly Period Ended March 31, 2009

No future grants will be made under the Company's stock option plans. No grants of stock options have been made by the Company since July 1, 2005. As of March 31, 2009, all outstanding options were non-qualified stock options.

The following table summarizes stock options outstanding and changes during the quarterly period ended March 31, 2009:

Options Outstanding and Exercisable				
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2008	58,000	\$ 2.33	4.5	\$ 712,000
Granted	-			
Exercised	-			
Options outstanding and exercisable at March 31, 2009	58,000	\$ 2.33	4.2	\$ 464,000

The total intrinsic value, or the difference between the exercise price and the market price on the date of exercise, of all options exercised during the quarterly period ended March 31, 2009, was zero. Cash received from stock options exercised during the quarterly period ended March 31, 2009 was zero.

Stock options outstanding and currently exercisable at March 31, 2009 are as follows:

Options Outstanding and Exercisable			
Range of exercise prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$1.25	18,000	1.1	\$1.25
\$2.26 - \$3.36	40,000	5.7	\$2.81
	58,000	4.2	\$2.33

Restricted Stock.

Under the restricted stock plan approved by our shareholders in July 2005, (the “Restricted Stock Plan”) directors, consultants and employees may be awarded shares of DXP’s common stock. The shares of restricted stock granted to employees as of March 31, 2009 vest 20% each year for five years after the grant date or 10% each year for ten years after the grant date. The Restricted Stock Plan provides that on each July 1 during the term of the plan each non-employee director of DXP will be granted the number of whole shares calculated by dividing \$75,000 by the closing price of the common stock on such July 1. The shares of restricted stock granted to non-employee directors of DXP vest one year after the grant date. The fair value of restricted stock awards is measured based upon the closing prices of DXP’s common stock on the grant dates and is recognized as compensation expense over the vesting period of the awards.

The following table provides certain information regarding the shares authorized and outstanding under the Restricted Stock Plan at March 31, 2009:

Number of shares	600,000
authorized for	
grants	
Number of shares	315,702
granted	
Number of shares	284,298
available for	
future grants	
Weighted-average	\$ 16.60
grant price of	
granted shares	

Changes in restricted stock for the three months ended March 31, 2009 were as follows:

	Number of Shares	Weighted Average Grant Price
Unvested at December 31, 2008	215,250	\$ 15.91
Granted	9,680	\$ 10.33
Vested	6,000	\$ 9.42
Unvested at March 31, 2009	218,930	\$ 15.84

Compensation expense, associated with restricted stock, recognized in the three months ended March 31, 2009 and 2008 was \$262,000 and \$227,000, respectively. Unrecognized compensation expense under the Restricted Stock Plan was \$2,930,000 and \$3,092,000 at March 31, 2009 and December 31, 2008, respectively. As of March 31, 2009, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 32 months.

NOTE 5: INVENTORY

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

	March 31, 2009	December 31, 2008
Finished goods	\$110,087	\$ 117,582
Work in process	1,637	1,515
Inventories	\$111,724	\$ 119,097

Note 6: GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill and other intangibles during the three months ended March 31, 2009 are as follows (in thousands):

	Total	Goodwill	Other Intangibles
Balance as of December 31, 2008	\$ 143,945	\$ 98,718	\$ 45,227
Acquired during the year	-	-	-
Adjustments to prior year estimates	998	998	-
Amortization	(1,806)	-	(1,806)
Balance as of March 31, 2009	\$ 143,137	\$ 99,716	\$ 43,421

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

	As of March 31, 2009		As of December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Vendor agreements	\$ 2,496	\$ (613)	\$ 2,496	\$ (582)
C u s t o m e r relationships	50,416	(9,917)	50,416	(8,289)
N o n - c o m p e t e agreements	1,920	(881)	1,920	(734)
Total	\$ 54,832	\$ (11,411)	\$ 54,832	\$ (9,605)

The \$1.0 million increase in goodwill from December 31, 2008 to March 31, 2009 primarily results from a reduction in the value of acquired inventories for Rocky Mtn. Supply, Inc., which was acquired during 2008. Other intangible assets are generally amortized on a straight line basis over the useful lives of the assets. All goodwill and other intangible assets pertain to the MRO segment.

NOTE 7. EARNINGS PER SHARE DATA

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

	Three Months Ended March 31	
	2009	2008 (Restated)
Basic:		
Weighted average shares outstanding	13,078,661	12,856,596
Net income	\$ 3,172,000	\$ 5,439,000
Convertible preferred stock dividend	(15,000)	(23,000)
Net income attributable to common shareholders	\$ 3,157,000	\$ 5,416,000
Per share amount	\$ 0.24	\$ 0.42
Diluted:		
Weighted average shares outstanding	13,078,661	12,856,596
Net effect of dilutive stock options – based on the treasury stock method	33,764	140,123
Assumed conversion of convertible preferred stock	840,000	840,000
Total	13,952,425	13,836,719
Net income attributable to common shareholders	\$ 3,157,000	\$ 5,416,000
	15,000	23,000

Convertible preferred stock dividend		
Net income for diluted earnings per share	\$ 3,172,000	\$ 5,439,000
Per share amount	\$ 0.23	\$ 0.39

NOTE 8: 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 to electrical contractors 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.

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 March 31,		
	MRO	Electrical Contractor	Total
2008			
Sales	\$ 167,596	\$ 903	\$ 168,499
Operating income	10,427	141	10,568
Income before taxes	9,087	111	9,198
2009			
Sales	\$ 156,919	\$ 685	\$ 157,604
Operating income	6,629	63	6,692
Income before taxes	5,222	31	5,253

NOTE 9: 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 the Company obtains additional information concerning certain asset and liability valuations, provided that such information is received no later than one year after the date of acquisition.

On February 1, 2008, DXP completed the acquisition of the business of Rocky Mtn. Supply, Inc. DXP acquired this business to expand DXP's geographic presence in Colorado. DXP paid approximately \$4.6 million, net of acquired cash, for this business. The purchase price consisted of approximately \$3.9 million paid in cash and \$0.7 million in seller notes. The seller notes bear interest at prime minus 1.75%. The cash portion was funded by utilizing available capacity under DXP's credit facility.

On August 28, 2008, DXP completed the acquisition of PFI, LLC. DXP acquired this business to strengthen DXP's expertise in the distribution of fasteners. DXP paid \$66.4 million in cash for this business. The cash was funded by utilizing a new credit facility.

On December 1, 2008, DXP completed the acquisition of the business of Falcon Pump. DXP acquired this business to strengthen DXP's pump offering in the Rocky Mountain area. DXP paid \$3.1 million in cash, \$0.8 million in seller notes and up to \$1.0 million in future payments contingent upon future earnings of the acquired business. The seller notes bear interest at ninety-day LIBOR plus 0.75%. The cash portion was funded using DXP's credit facility.

The allocation of purchase price for all acquisitions completed since March 31, 2008 are preliminary in the December 31, 2008 and March 31, 2009 consolidated balance sheets. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in the estimates of the fair value of assets acquired (primarily inventories) and liabilities assumed. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed since March 31, 2008 in connection with the acquisitions described above (in thousands).

Accounts Receivable	\$ 9,210
Inventory	24,422
Property and equipment	2,625
Goodwill and intangibles	44,657
Other assets	274
Assets acquired	81,188
Current liabilities assumed	(5,165)
Non-current liabilities assumed	(5,759)
Net assets acquired	\$ 70,264